

1985

Monetary policies in a small open economy: the case of the Netherlands Antilles

Armand Louis Stanley Piqué
Iowa State University

Follow this and additional works at: <https://lib.dr.iastate.edu/rtd>



Part of the [Economics Commons](#)

Recommended Citation

Piqué, Armand Louis Stanley, "Monetary policies in a small open economy: the case of the Netherlands Antilles" (1985). *Retrospective Theses and Dissertations*. 17116.
<https://lib.dr.iastate.edu/rtd/17116>

This Thesis is brought to you for free and open access by the Iowa State University Capstones, Theses and Dissertations at Iowa State University Digital Repository. It has been accepted for inclusion in Retrospective Theses and Dissertations by an authorized administrator of Iowa State University Digital Repository. For more information, please contact digirep@iastate.edu.

20-1
Monetary policies in a small open economy:

The case of the Netherlands Antilles

ISU
1985
P662
c. 3
by

Armand Louis Stanley Piqué

A Thesis Submitted to the
Graduate Faculty in Partial Fulfillment of the
Requirements for the Degree of
MASTER OF SCIENCE

Major: Economics

Signatures have been redacted for privacy

Iowa State University
Ames, Iowa

1985

1533591

TABLE OF CONTENTS

	Page
1. THE NETHERLANDS ANTILLES: A BIRD'S EYE VIEW	1
1.1. Geography	1
1.2. History	4
1.3. Toward Autonomy	6
1.4. The Constitution	7
1.5. The Economy	11
1.6. The Fiscal System of the Netherlands Antilles	30
1.7. Summary and Conclusion	35
2. MONETARY FINANCIAL INSTITUTIONS	41
2.1. Development Process of Commercial Banking System in the Netherlands Antilles	41
2.2. Offshore Banks	66
2.3. Giroservice	81
3. NONMONETARY BANKING INSTITUTIONS	86
3.1. Introduction	86
3.2. Institutions	87
3.3. Institutional Investors	88
3.4. Credit Unions	97
3.5. Ontwikkelingsbank van de Nederlandse Antilles	101
4. FINANCIAL MARKETS	110
4.1. Introduction	110

	Page
5. THE CENTRAL BANK OF THE NETHERLANDS ANTILLES	119
5.1. History	119
5.2. The Formal Structure of the Bank van de Nederlandse Antillen	120
5.3. Internal Organization of the Bank van de Nederlandse Antillen	124
5.4. Functions of the Bank van de Nederlandse Antillen	126
5.5. Supervision of Banks and Credit Regulation	129
5.6. Foreign Exchange Regulations	139
5.7. Monetary Policy in the Netherlands Antilles	146
5.8. Policy Instruments of the Bank van de Nederlandse Antillen	151
5.9. Factors Constraining Monetary Policy of the Central Bank	156
5.10. Summary	159
5.11. Remarks	163
5.12. Some Comparisons	169
5.13. Conclusion	171
5.14. Suggestions	171
6. REFERENCES	180
7. ACKNOWLEDGMENTS	184
8. APPENDIX 1	185
9. APPENDIX 2	186

1. THE NETHERLANDS ANTILLES:

A BIRD'S EYE VIEW

On my arrival at Iowa State University, I noticed that most students and professors had never heard about the Netherlands Antilles. Some thought it to be a country in Africa while others thought it to be in Europe. Only the students from Latin America and the Caribbean knew that it was a group of islands located in the Caribbean. Hence, I decided to provide the readers, who know little or nothing about this country, some insight in the geographical, historical and political situation of the country as well as some background information about the economy and fiscal system at this point in time. Readers who are already familiar with the general nature of the Netherlands Antilles can continue with Chapter 2.

1.1. Geography

The Netherlands Antilles consist of six islands that lie in the Caribbean area. In Dutch reference books, they are also classified as the Leeward Islands:¹ Aruba, Bonaire and Curacao; and the Windward Islands: St. Maarten,² St. Eustatius and Saba.

1.1.1. The Leeward Islands

The Leeward Islands are located in the southern part of the Caribbean, 38 miles north of Venezuela, outside of the hurricane area. Curacao is the largest island in this group with 64% of the total population (see Table 1.1).

Table 1.1. Area and population of Netherlands Antilles^a

	Island	Capital	Land area in miles ²	Population
Leeward Islands	Aruba	Oranjestad	74	63,000
	Bonaire	Kralendijk	111	9,000
	Curacao	Willemstad	172	161,000
Windward Islands	St. Eustatius	Oranjestad	8	1,400
	Saba	The Bottom	5	1,000
	St. Maarten	Philipsburg	13 ^b	16,000

^aData source: Beers, H. C. The Financial Sectors of the Netherlands Antilles. Goslinga, Cornelis Ch. A Short History of The Netherlands Antilles and Surinam.

^bSix square miles is Dutch territory. The rest is French territory.

The climate of this group of islands is tropical with an average annual temperature of 81°F. September is the hottest month, January and February are the coolest. The sun is in Zenith twice a year: April 22 and August 22. Average yearly rainfall is around 22 inches on Curacao, 20 on Bonaire, and 18 on Aruba. There are two rainy seasons: one from October to January and a shorter one in May or June. The wind blows from the northeast to the southwest with a steady velocity of ten miles per hour.³

The flora of the islands is predominantly xerophitic and very similar to the flora of the nearby coast.⁴ The fauna of the islands is still being inventoried.⁵ There are no big native animals. The Spaniards imported goats, horses, and cattle.

1.1.2. The Windward Islands

The Windward Islands⁶ are perched on the northern rim of the Lesser Antilles, near to Puerto Rico. They are located in the area of both the trade winds and the hurricanes. The climate is tropical with a temperature steady at 79°F. Average yearly rainfall is between 40 and 46 inches. The Dutch half of St. Maarten has good salt pans. Saba is a high hill and is therefore somewhat cooler than the other two, while St. Eustatius lies lower and is warmer. St. Maarten is the largest island in this group.

The geographic position of both the Leeward Islands and the Windward Islands allowed for active international trade and services and intensive relations with North and South America as well as Europe.

The main economic activities are located on Aruba and Curacao (industry, tourism and trade) and on St. Maarten the tourism industry is flourishing. The "lingua franca" on the Leeward Islands is Papiamentu; on the Windward Islands English. The official language, however, is Dutch, while English and Spanish are widely spoken. The indigenous people of the islands are indians, however, there is not one to be found on the islands. When the Dutch, in the sixteenth century, arrived on these islands, the Spanish governor left for the mainland of Venezuela with all the remaining indians. This leads us into the next topic, namely, the history of the Netherlands Antilles.

1.2. History

In 1499, the Spanish conquistador Alonso de Ojeda discovered the islands Bonaire, Aruba and Curacao. These islands were inhabited by the peaceable Caiquetíos, a coastal tribe of the Arowak Indians occupying the nearby mainland of Venezuela. From 1499 until 1630, these islands were under Spanish dominion, and so were St. Maarten, St. Eustatius and Saba.

In 1626, the Dutch, in their desperate need for salt for their prosperous herring industry, landed on Bonaire. In 1630, they conquered St. Maarten, in 1634 Curacao. A month later they occupied Aruba and from St. Maarten they took St. Eustatius in 1636 and Saba in 1641. After the defeat, the Spanish governor left with all the remaining Indians for the mainland.

The Dutch kept the islands for their strategic location, salt and to acquire a firm foothold in the Caribbean for their empire around the Atlantic. They built a waterfort at the entrance of the harbor of Curacao to protect themselves, and once they felt themselves and their property secured, a busy traffic in salt, wood from Brazil and slave trade from Africa began. The first settlers cultivated tobacco and sugar but when export became impossible, depending on with whom the Dutch were at war or allied, smuggling and privateering became common practices.

The eighteenth century was a time of almost undisturbed prosperity. The islands were not always under Dutch dominion. Several times they

have been under English and French dominion, due to the wars between Holland and England. In this century, St. Eustatius was called the Golden Rock. Governor Johan de Graaff from St. Eustatius, in 1778, recognized the rebellious colonies of Great Britain in America, not as a rebel but as a promising client by firing nine salute shots. This act annoyed England so much that in 1780 Admiral Sir George Bridged Rodney set out for the Golden Rock and destroyed it. The island never recovered its former prosperity.

The nineteenth century was a difficult time for the islands. The economy was not growing and the government faced huge budget deficits. A report of 1825 called Curacao a bare improductive rock. In Holland, however, King William I dreamt of making Curacao the nerve center for the interchanges between America and Europe -- or, at least, to turn the islands into a port of access to Central and South American market for Dutch traders. He dispatched commercial envoys to the Caribbean and Latin America to foster trading and also the political interests of The Netherlands. The objective of the measures was not the economic development of the colony for its own sake but the expansion of Dutch trade and sale of Dutch products in Latin America. Curacao had to be safe and an open market place. Safety could be assured if Curacao became a Caribbean Malta. Openness called for abolition of duties and discriminatory provisions on trade and shipping. However, opting for the side of Spain against the rebels in Venezuela, he lost the full advantage of important commercial opportunities. The struc-

tural changes which had taken place in the Caribbean since 1789 made the West Indian Islands less important to their metropolitan owners. The rise of the United States also brought a shift in trading patterns. In 1822, the policies were changed. The negative attitude towards Bolivar's struggle was abandoned in favor of neutrality, and in 1829, Holland officially recognized the Republic of Grand Columbia.⁷ These steps were beneficial for the colonies. In 1863, slavery was abolished.

The twentieth century, at least the first half, was a period of new hope and prosperity for the islands. The discovery of crude oil in Venezuela and the refinement of this oil in Curacao and Aruba by Shell and Lago (Exxon) altered the economic structure of the islands. The higher wages and fringe benefits of the oil industry caused a shift from the traditional sector to the oil sector. Immigration from Holland, Surinam and other Caribbean islands increased dramatically. Trade and tourism increased and the economy started growing again. The establishment of the refineries in the Antilles is due to the following reasons: Venezuela was politically unstable, its ports had poor facilities, its climate was unhealthy, and Curacao was close to Europe, Maracaibo and New York. The second half of the twentieth century will be explained in the section: The Economy.

1.3. Toward Autonomy

From the sixteenth century until the nineteenth century, the islands were colonies of Holland. In the early twentieth century the word was changed from colony to dominion. The colonial status was

changed to States of Curacao.

The feeling that in reality nothing had changed and that Holland was still in control led to the organization of political parties. In 1936, the Roman Catholic Church was the first to enter the political arena. In 1944, the Democratic Party was founded. The growing demand for autonomy contributed to the popularity of the latter, and in 1948, they won the elections. In 1942, Queen Wilhelmina, then in exile in London, promised self-government to the Dutch East and West Indies once the war was over. After the Second World War a number of Round Table Conferences were held and finally in 1954 the so-called Statute (Statuut in Dutch) was drafted, discussed, amended and adopted as a permanent basis for the relations between the three partners. The monarchy was to consist of The Netherlands, The Antilles and Surinam.⁸ The crown reigns over each of the partners, while a Council of Ministers was set up, composed of The Netherlands Ministers and Surinam to discuss all matters concerning the three partners of the Kingdom. The Netherlands, the Netherlands Antilles and Surinam were considered equal partners. Autonomy became a reality.

1.4. The Constitution

The constitution of the Netherlands Antilles is taken to mean the organization of the Government of the Netherlands Antilles. However, in the Netherlands Antilles we don't use the word "constitution," but the "polity act." In other countries, this document of state is called the constitution.

Together with The Netherlands, the Netherlands Antilles make up the territory of the Kingdom of The Netherlands and any person belonging to one of the parts of the kingdom is a national of The Netherlands.

The territory of the Netherlands Antilles is formed by four so-called insular territories, viz:

1. the insular territory of Aruba, which includes the island of Aruba;
2. the insular territory of Bonaire, which includes the island of Bonaire and Klein Bonaire;
3. the insular territory of the Windward Islands, which includes the islands of Saba, St. Eustatius and St. Maarten (Dutch part);
4. the insular territory of Curacao, which includes the islands of Curacao and Klein Curacao.

The Polity Act of the Netherlands Antilles distinguishes three powers: the legislative, the executive and the judiciary. The legislative powers are exercised by the Governor jointly with the "Staten" or Parliament. The executive is exercised by the Governor,⁹ and the judiciary by judges¹⁰ appointed for life by the Queen.

1.4.1. The Governor

The Queen is the Head of Government of the Netherlands Antilles. Due to her residence in The Netherlands, she is represented in that capacity by a Governor, who is appointed and removed by her. Therefore, the Government of the Netherlands Antilles is formed by the Governor and the Council of Ministers.

1.4.2. The Advisory Council

The Advisory Council consists of not less than five members appointed by the Governor, one of whom is the vice-chairman. They are an advisory body and advise the Governor when requested or of their own accord. The members are in office for a period not exceeding five years and are immediately eligible for reelection.

1.4.3. The Council of Ministers

With the Governor, this body constitutes the government of the Netherlands Antilles and consists of not more than nine ministers who are in charge of the departments of general administration and are appointed by the Governor after consultation with the "Staten" (parliament) and after the Advisory Council has advised on the appointment.

1.4.4. The "Staten" or parliament

The Staten represent the entire population of Netherlands Antilles. The Staten consist of 22 members elected as follows: 1) 8 members are elected by the insular territory of Aruba, 12 by Curacao, 1 by Bonaire and 1 by the insular territory of the Windward Islands.

In Aruba and Curacao, the election takes place on the basis of proportional representation, which means that the various parties are entitled to a number of seats pro rata to the number of votes they have obtained in the elections. The members are elected for a 4-year period. They retire from office simultaneously and may be reelected immediately. On their accession to office as members of parliament, the members are required to present their credentials.

The annual assembly of the Staten is opened by the Governor on the second Tuesday of the month of May; in this opening speech, he reviews the financial and economic situation of the country. The president and vice-president of the Staten are appointed by the Governor. Legislative power is exercised by the Staten jointly with the Governor. The Staten have the powers of initiative, amendment, address with questions, inquiry and budget.

1.4.5. Franchise

A distinction is made between the right to vote and the right to be eligible for election. The Staten are elected in universal suffrage of men and women; eligibility for election applies to both men and women. Election is direct and by ballot. A voter must be at least 21; a person eligible for election must be at least 23 years of age.

The Netherlands Antilles are not governed out of one central point. Each of the four insular territories has been granted autonomy for attending to their own affairs. Therefore, they enact their own insular ordinances, and in certain cases they can execute ordinances of the Central Government independently.

The administration of each insular territory is conducted by the Island Council, the Executive Council and the Lieutenant Governor. The members of the Island Council (a legislative body) are elected by the voters of the insular territory on the basis of proportional representation.

On the islands of Aruba and Curacao, the Island Councils consist

of 21 members each; those of Bonaire and the Windward Islands consist of 9 and 15 members, respectively. The members of the Island Council are elected for a four-year term. The Lieutenant Governor is the chairman of the Island Council; however, he does not have the right to vote, he can only advise. The members of the Staten (parliament) of the Netherlands Antilles and the members of the Island Council and the Lieutenant Governor enjoy immunity.

The Lieutenant Governor is appointed by the Queen for a six-year term. He must be at least 25 at the time of his appointment. He is a member of, and presides over, the Executive Council of his insular territory and he is responsible for execution of the resolutions of the Island Council and the Executive Council, and, moreover, he is the local chief of police.

1.5. The Economy

The Netherlands Antilles economy is very small and very open. It has a narrow production base and almost everything consumed or invested has to be imported.

In standard open macroeconomics, smallness of an open economy is often defined in terms of a macroeconomic variable such as GNP or in terms of price-taking behavior.

The use of a macro variable such as real GNP, capital or labor force to define smallness involves a practical problem for these small islands -- namely the lack of data.

Defining a country as small on the basis of being unable to in-

fluence world prices for goods and assets involves the problem that almost all countries are price takers and hence small in this sense, because price taking is only one of the characteristics of smallness. The degree of openness to trade and capital movements and export dependence are other characteristics that bear directly on the conduct and effectiveness of economic policies in ministates (as they are also called).

Ministates are often defined as states or territories with a population of less than one million people. Hence, we can say that the Netherlands Antilles with a total population of 251,400 people falls within this category.

General characteristics of ministates or territories are:

- 1) small population, hence a small labor supply and lack of skilled laborers;
- 2) small domestic market hampering the establishment of large-scale industries;
- 3) limited land area and natural resources;
- 4) prices are given, leading to imported inflation;
- 5) narrow production base, often one or two primary products or industries mainly producing for exports;
- 6) restricted export markets and import suppliers;

The Netherlands Antilles is no exemption to these characteristics, as will become evident in the sectoral analysis.

The geographic fragmentation of the islands and the remoteness of the Windward Islands has resulted in a heavy infrastructure and high transportation cost between the Leeward and Windward Islands. Here,

remoteness refers to the geographic distance between the two groups of islands. (Note: There is a 500-mile distance between the Leeward and Windward Islands.)

The limited land area, small population, high labor costs, absence of raw material and the small size of the domestic market are constraints that preclude the establishment of large-scale capital-intensive industries. Such industries will not be able to take advantage of increasing returns to scale or even reaching technically or economic optimum size unless they can export a large portion of their output.

1.5.1. Sectoral development

In this section, I shall only describe the leading economic sectors, namely: tourism, transportation, financial offshore and oil refinery.

Description of these sectors provides some general knowledge of economic welfare in these leading sectors of the Antillean economy during the last few years and can be considered a way of assessing national income.

1.5.1.1. Tourism Tourism can be described by the development of the number of people visiting the Antilles and the receipts of tourist-spent foreign exchange. Table 1.2 shows the number of tourists visiting Aruba, Curacao, Bonaire and St. Maarten during 1980-1982.

From Table 1.2, it will be noted that the total number of visitors to Curacao has been declining since 1980. This is due to lack of a rigorous promotional campaign. Aruba experienced a modest decline in

Table 1.2. Tourism per island (x1000)^{a,b}

	1980	1981	1982	1983
Aruba:				
Total stay-over visitors	188.9	221.3	220.2	195.1
Total visitor nights	1192.5	1285.5	1357.2	1252.6
Cruise	73.4	54.7	51.1	39.1
Curacao:				
Total stay-over visitors	184.7	176.1	174.4	110.9
Total visitor nights	863.2	691.1	778.3	-
Cruise	169.0	129.3	109.9	107.1
Bonaire:				
Total stay-over visitors	22.6	26.0	28.0	20.2
Total visitor nights	106.0	117.8	126.0	79.7
Cruise	2.9	12.0	6.8	290.0
St. Maarten:				
Total stay-over visitors	204.7	190.5	213.4	263.3
Total visitor nights	-	-	-	-
Cruise	105.4	106.0	98.3	73.0

^a Stay-over and cruise tourism: number of tourists.

^b Central Bank Quarterly Bulletin, 1984, Vol. 3.

1982. In Bonaire and St. Maarten, tourism kept growing. However, in 1983, all the islands but St. Maarten experienced a significant decline in tourism. In Curacao, the decline was 36% in 1983 over 1982, in Aruba 11.4%, in Bonaire 27.9%. Cruise ship calls also declined steadily over all the islands since 1980.

The reason for this decline in tourism was the devaluation of the Venezuelan bolivar and other restrictions imposed by the Venezuelan authorities on foreign transactions. In order to stop the outflow of

foreign exchange, Venezuela stopped all charter flights.

During the month of April, tourism from Venezuela to Curacao was virtually nonexistent. Only 712 Venezuelans visited the island compared with 6,512 during April 1982. The Venezuelan ferry tourism declined by nearly 80%. The following table illustrates the tremendous decline in Venezuelan tourists.

Table 1.3. Stay-over tourism by island from Venezuela (x1000)^a

	1982	1983	Percentage change
Aruba	74.4	28.5	-61.7
Curacao	94.0	26.4	-71.0
St. Maarten	4.8	1.4	-70.0
Bonaire	4.4	2.3	-47.7

^aCentral Bank Quarterly Bulletin, Vol. 3, 1984.

This sudden drop in Venezuelan tourists had an adverse effect on income and employment in the tourist and free-trade zone sector in Curacao and Aruba. Several shops closed their doors and laid off personnel. Table 1.4 shows the decline in the inflow of bolivars. Receipts from tourism as recorded on the balance of payment decreased from Naf. 776 million in 1982 to Naf. 577 million in 1983, a decline of 25.6% in 1983 over 1982. Corrected for an inflation rate of 2.2% in 1983, this means a real decrease of 27.8% in 1983. Thus, 1983 as a tourist year is characterized by less tourists who also spent less.

Table 1.4. External cash flow: currency survey 1982 - IV (in millions)^a

Flow	Currency	Bolivar	US \$
Inflow 1982		44.4	564.5
1983		2.9	517.1

^aCentral Bank Quarterly Bulletin, Vol. 3, 1984.

In terms of domestic and national income, the direct contribution of tourism in 1983 to the Leeward Islands has declined. To stimulate tourism, the Central Government deleted import duties on tourist articles such as watches, crystal and porcelain. Promotion and expansion to other markets in Latin America and the Caribbean will be necessary to offset the loss of receipts due to the decline in Venezuelan tourism.

1.5.1.2. Transportation Curacao has the lowest pilotage dues in the Caribbean Basin (for cruise ships these dues are zero). In other words, the total cost for freighters is far below the average of other harbors.

Despite these advantages, the number of ships calling in the harbors of Curacao and Aruba declined from 10,362 in 1982 to 7,672 in 1983. This meant less activity for local shipchandlers and other harbor-related business.

The worldwide recession and decline in demand for shipping repair orders adversely affected the Curacao Docking Company (C.D.M.). To solve the lack of demand at the company, the Venezuelan authorities

were willing to repair their ships at the docking company. At least 12 ships of their fleet would be docked in Curacao.

The Dutch, Central and local government also gave the company a financial injection in 1982. But it was not enough to save the company. In 1983, the C.D.M. recorded a loss of Naf. 36 million despite the fact that the employees gave in 25% of their income. The company laid off 290 employees.

The good harbor and excellent infrastructure of Aruba and Curacao allowed for the opportunity of taking advantage of the rapid container development in the world. Hence, a container harbor was constructed and put into operation in 1983, in order to improve the level of activities. The foreign exchange inflow originating from ship repairing activities decreased by 49% (Naf. 41 million).

The national carrier (Dutch Antilles Airways or A.L.M.) recorded a loss of Naf. 11 million in 1982 and the forecast for 1983 was Naf. 25 million, due to overstaffing and high labor costs (wages), a strong decrease in passengers and difficulties in transferring proceeds in convertible currency from a few countries in the region with balance of payment problems.

In order not to increase the already high unemployment rate, emergency plans were designed with the aim of reducing labor costs by at least 25% without layoffs.

The balance of payments shows that overall transportation revenues (gross) decreased from Naf. 374 million in 1982 to Naf. 374 million in 1983, a decline of 16.6%.

1.5.1.3. Financial offshore The offshore sector consists mainly of financial activities. It became of importance for the Antilles because of tax-treaties between the Netherlands Antilles and other countries, mainly the U.S.A. and The Netherlands, and the indirect tax treaties through the treaties The Netherlands has with other countries.

In 1984, the U.S. government approved the repeal of the 30% withholding tax on portfolio interest paid to foreign investors. The bill repealed the tax for borrowings issued after enactment of the legislation.

This measure was a severe blow to the offshore business. By repealing the withholding tax on interest, the United States corporations don't need the Netherlands Antilles any more to do business in the Eurodollar market. They can now do it directly. Hence, the future of the financial offshore sector experienced a substantial setback and its future clouded with uncertainty. However, there is some optimism about the point in time they will become effective. A period of seven years is expected before a reduction in the revenues will become evident. During 1983, the high level of interest rates, as well as the recovery of economic activity and the monetary policy of the United States, caused the establishment of finance companies to continue.

The presence of offshore companies is important as they contribute to tax income, and foreign exchange revenue as well as employment. About 1000 people are employed by the offshore companies.

Revenues from offshore companies amounted to Naf. 519 million in 1983 compared to Naf. 404 million in 1982. Table 1.5 shows the number of offshore companies in the Netherlands Antilles.

The future of the offshore business depends upon what happens in the U.S.A. and The Netherlands and, hence, the development is uncertain. The offshore sector, however, did contribute positively to employment and income during the past five years.

Table 1.5. Number of^a offshore companies established in the Netherlands Antilles

	Foreign exchange licenses issued	Total number of offshore companies
1980	5,001	24,335
1981	4,120	28,455
1982	3,359	31,814
1983	2,105	33,919

^aCentral Bank Quarterly Bulletin, 1983, Vol. 4.

1.5.1.4. Oil refinery sector The refining of petroleum has been the major economic activity of the Netherlands Antilles. This branch of industry comprises two large refineries -- namely, Shell Curacao and the Lago (Exxon) on Aruba.

For years, they were the largest employers in the Netherlands Antilles but the establishment of refineries close to their markets (Europa), the oilshock of 1973, and the protective measures taken by

the U.S.A. against possible oilshocks changed the nature of the industry.

These factors caused massive layoffs and rigorous rationalization of the oil refineries. The number of people employed nowadays at Shell Curacao is less than 3,000 and at Lago less than 1,000. This sector accounts for 15-20% of estimated G.D.P. During 1978-1979, the refining output declined from 1,020,000 barrels per day to 880,000 barrels per day leaving both Lago and Shell with excess refining capacity.

On October 31, 1984 Exxon announced the termination of Lago's activities and informed the Government of the Netherlands Antilles that on March 31, 1985, the plant will shut down indefinitely. This means that Aruba, with basically two sources of income -- namely, oil refinery and tourism -- will have its unemployment rate increase from 15% to 40%, and 900 workers will lose their jobs. It is estimated that 30-40% of the population lives off Lago. Profit revenues account for more than 30% of the island's total income in 1984. Moreover, the refinery is the largest customer of the island's utility sources. In 1980, the oil refineries had combined profits almost 50% lower than the year before.

Lago closed the doors due to:

- 1) the increase in losses resulting from the difficult competitive circumstances;
- 2) Venezuela bound by the OPEC agreement was unable to provide Lago with the required minimum supply of crude to guarantee break-even point;

- 3) the decline in demand for oil products;
- 4) worldwide over-capacity hampered prospects for improvement.

Since 1981, Shell Curacao has been recording losses. In 1982, Shell recorded a loss of Naf. 158 million; in 1983, Naf. 42 million. Total operational loss for the company's first half of 1984 reached Naf. 65 million.

To continue operations, Shell offered the government the following proposal:

- 1) major participation of the Netherlands Antilles government in the refinery (2/3 of the shares of Shell) in order to obtain a preferential treatment, as Venezuela recently declared that multinationals will not be subsidized;
- 2) emission of a decree to lay off excess personnel in order to decrease costs (The Dismissal Law inhibits lay off of personnel in permanent service);
- 3) an increase in the supply of crude oil from Venezuela.

Major participation of the government in Shell Curacao is a risky business as international developments in the oil sector indicated for years the growing obsolescence of refineries in locations like Aruba and Curacao, where crudes have to be imported. It also means that the government will bear the largest part of losses made by Shell Curacao. Major participation of the government also does not imply that Venezuela will be compelled to supply Shell with more crude. Hence, the future of Shell is uncertain and for the government a risky adventure. The refineries did not contribute to more employment and their share in income also declined during the past few years.

There are other sectors like agriculture, manufacturing, and construction, but they are of minor importance to the economy. Agricultural development has been hampered by the scarcity of water and good soil, so it cannot develop with low skill intensity and a low capital base and is forced to develop along high technology lines. Manufacturing is confined to consumer goods and simple intermediate goods, in particular those favored through almost prohibitive freight costs, high import tariffs or prohibitions. Industrial growth is constrained by reasons mentioned in the beginning. However, the development of small-scale industry is possible. Construction is hampered due to the fact that small firms lack the expertise and financial capacity to undertake larger sized projects. These are often carried out by foreign contractors. The constraints on a ministate economy are evident in all the sectors of the economy of the Netherlands Antilles.

1.5.2. Balance of payment

The narrow resource base and absence of a well-developed agricultural sector are the reason that all goods have to be imported, both for consumption and productive purposes. Domestic production of goods for the local market is very small. Hence, the balance of payments is characterized by deficits on merchandise account. Surpluses on current account of the balance of payment can only be achieved by a favorable balance of services, or by offsetting capital inflows. Table 1.6 gives an illustration of the merchandise account on the basis of available data.

Table 1.6. Merchandise account (millions of Netherlands Antilles guilders)^a

	1978	1979	1980	1981	1982
Oil export	5,187.7	7,533.4	10,672.4	10,306.9	9,077.4
Oil import	5,057.6	7,063.1	10,599.6	10,144.9	8,425.9
Net oil balance	130.1	470.3	112.8	162.0	581.5
Nonoil exports	200.8	191.6	224.3	260.0	188.3
Nonoil imports	1,226.2	1,329.5	1,627.4	1,756.2	1,857.8
Net nonoil balance	-1,025.4	-1,137.9	-1,402.1	-1,495.4	-1,669.5
Merchandise balance	- 895.3	- 667.6	-1,290.3	-1,333.4	-1,088.0

^a Central Bank's annual report 1979-1980. Quarterly Bulletin, Vol. 4, 1983.

The significance of oil is clearly reflected on this merchandise account. The net nonoil balance is constantly negative and increasing. The increase in net oil export was due to an increase in export prices of oil. However, in 1981 and 1982, the export of oil decreased due to a decrease in the demand for oil products. The contribution of the oil refineries also shows in the invisible account. Table 7 shows the invisible account.

Imports are paid in foreign currency and this is earned by rendering services. From Table 1.7, we see that tourism is a very important source of foreign exchange. Revenues from tourism increased by 17% in 1979 and by 21% in 1981. The net contribution of tourist expenditures

Table 1.7. Invisible account (millions of Netherlands Antilles guilders)^a

	1978	1979	1980
Bunker	310.0	558.8	589.2
Ship repair	61.5	70.6	103.0
Storage fee	198.8	203.8	214.8
Other transportation	80.9	119.9	140.1
Tourism	410.9	476.7	586.2
Direct investment income	-239.3	-728.7	-446.4
Other investment income	- 18.3	- 77.0	- 24.4
Offshore profit taxes	77.0	62.4	100.5
Government	11.4	17.4	16.3
Other services	- 57.7	- 9.6	- 71.4
Invisible balance	835.2	686.3	1,207.9

^aCentral Bank's annual report 1979-1980.

to the balance of payments, amounted to Naf. 480 million in 1979 and Naf. 590 million in 1980.

Transportation, comprised of ship repair, airline company port charges and the rendering of services to shipping, is another foreign exchange generator.

The trend in tourism and transportation remained favorable, until 1983 and then it reversed, due to depreciation of the bolivar. Table 1.8 illustrates the change in this trend.

Revenues from all the sectors declined. Only the financial off-shore sector generated tax revenues to the government. The wages and

Table 1.8. Inflow current account by sector (millions of Netherlands Antilles guilders)^a

	1982	1983	Change
Revenues (gross)	776	577	-199
Tourism	776	577	-199
Transportation	392	312	- 80
Financial offshore	404	519	155
Refineries	511	444	- 67
Other	267	156	-111

^aCentral Bank Quarterly Bulletin, Vol. 4, 1983.

salaries paid by offshore banks as well as the management fees of the trust offices is recorded under "other services." Income from offshore activities of the domestic deposit banks is recorded under other investment in the balance of payment on the investment account. The contribution of the offshore companies to the economy of the Netherlands Antilles is of great importance.

In 1978 and 1979, large outflows of capital occurred, while at the same time, foreign loans and grants decreased. Factors that contributed to this are the monetary financing of government deficits together with rapid credit expansion by the private sector. As domestic credit and international reserves are inversely related, the increase in domestic credit caused a decline or a loss in reserves. The low interest rate in the Netherlands Antilles as compared to the rest of the world also reinforced the outflow of capital. At the end of 1979, the reserves had

been restored to a level of Naf. 194 million. In 1980, a further growth took place with more than Naf. 50 million to Naf. 246 million.

The protection of the foreign exchange reserves, in order to finance imports and to maintain the external value of the Antillean guilder is one of the most important objectives of economic policy.

1.5.3. Unemployment

According to the last census, 20% of the labor force is unemployed in Curacao as the following table shows.

Table 1.9. Estimated situation as per end of 1978

Island	Population	Labor force	Employed	Unemployed	% of labor force unemployed
Aruba	63,000	24,000	22,500	1,500	6
Bonaire	9,000	3,000	2,500	500	16
Curacao	161,000	58,000	47,000	11,400	20
Saba	1,000	300	240	60	20
St. Eustatius	1,400	450	380	70	17
St. Maarten	16,000	5,600	5,600	-	0

^aH. C. Beers, An Introduction to the Financial Sectors of the Netherlands Antilles.

Unemployment is still growing especially among the youth and women.

The lack of employment opportunities and rapid growth of the labor force as well as the mismatch between the demand for labor and the supply of labor are the cause of this high percentage. Most employers also oppose the legal minimum wage and Dismissal Law. The minimum wage raises

their costs and the Dismissal Law makes it difficult for them to lay off excess or unproductive personnel, hence, they don't create more employment opportunities.

Most of the unemployed are low-skilled workers and the demand is for highly-skilled workers.

The government as the largest employer has realized that a further expansion of public sector employment will lead to problems of public finances and, due to the openness of the economy, also lead to balance of payment deficits.

1.5.4. Currency

The currency of the Netherlands Antilles is the Netherlands Antilles guilder (Naf.). The guilder is divided in 100 cents. On the Windward Islands, the guilder and the U.S. dollar circulate concurrently. The Netherlands Antilles guilder is pegged to the U.S. dollar. The commercial buying rate is Naf. 1.79 per U.S.\$1 and selling rate: Naf. 1.81 U.S.\$1 (excluding government tax of 13%).

1.5.5. Inflation

The openness of the economy means that the major part of inflation in the Netherlands Antilles is imported. Domestic prices are largely determined by international inflation and exchange rate movements. In 1978, we had an inflation rate of 6.3%. In 1980, it went up to 16%, but with the decrease of the inflation rate in the United States, our major trading partner, inflation decreased to 4.7% in 1982 and 2.2% in 1983. The stable import prices from Europe also helped to keep inflation down.

1.5.6. Development aid

The Netherlands Antilles is one of the largest foreign aid receivers in the world. The total aid received via the balance of payment of Naf. 87.9 million in 1979 and Naf. 179.1 million in 1980, amounted to an average of Naf. 535 per capita per year. In this increase was an amount of Naf. 34.3 million special foreign exchange aid.

Special forms of support to the balance of payment are the compensations of exchange rate losses for the national airline company and the Curacao Docking Company as well as a number of hotels in Aruba and Curacao.

The redemption and the interest payments of these development aid loans are in Dutch guilders. Above mentioned support comprises a non-recurrent aid of Naf. 6.5 million of which Naf. 2.4 million is a noninterest-bearing advance for the financing of redemptions and the remaining part is a subsidy for the interest payments. Development aid is used for development projects and almost all development aid comes from Holland.

The European Economic Community also provides the Netherlands Antilles with development aid. Aid is also received from organizations like the United States (Internal Labour Organization).

1.5.7. Socio-economic data

This section is based on data of 1979 and 1980, as data for national income accounts of 1981-1984 were not available.

Gross domestic product in 1980 was Naf. 2,435.91 million, a 10.4%

increase over 1979. When corrected for inflation, however, (16% in 1980) in real terms the increase was negative (-5.6%).

Gross national product or gross national income, on the contrary, was growing at a rate of 18%. Corrected for an inflation rate of 16% in 1980, it means that in real terms GNP grew with 2%.

This favorable development of national product in 1980 is mainly due to the increase on the account of primary income from abroad. The latter, in 1979, showed an outflow of Naf. -81.4 million. However, in 1980, this trend reversed into an inflow of Naf. 75.5 million because of a receipt of Naf. 35 million more in profit taxes from the offshore sector, and also less primary income was transferred abroad.

Net national income (at factor cost) rose from Naf. 1,791.2 million in 1979 to Naf. 2,146.6 million in 1980. This means an increase of 20%. National income per capita in 1979 was Naf. 7,774 and in 1980 Naf. 9,255. Corrected for inflation, it meant an increase of 3%.

The crude birth rate and crude death rate per 10,000 people is eight and five, respectively, while infant mortality per 1,000 live births amounts to 25.

Population per physician is 1,000 and the population per hospital bed is 14. More than 95% in the urban and rural area has access to piped water.

The adult literacy rate in the Netherlands Antilles is 96% and primary school enrollment is 99%.

The above mentioned data indicate that the Antilles can be con-

sidered in the middle income countries and that the Netherlands Antilles are better off than most of their neighboring islands or countries.

1.6. The Fiscal System of the Netherlands

Antilles

The public financial sector of the Netherlands Antilles is comprised of the Central Government, four Island Governments and the Social Insurance Bank (S.V.B.). All major taxes, like income and profit taxes, real estate and occupancy taxes, customs and excise duties, are levied by the Central Government.

The Island Governments' taxing powers are limited to a surtax of up to 30% income tax and of up to 15% on the profit tax, to taxes on motor vehicles and some miscellaneous levies such as licensing fees.

The Island Governments collect direct taxes and the Central Government collects indirect taxes.

The Central Government and the Island Governments of Aruba and Curacao have a revenue-sharing arrangement. Aruba and Curacao have a revenue-sharing arrangement. The Island Regulation Netherlands Antilles (E.R.N.A.) from 1951, and changed in 1978 but without ratification, stipulates that the Islands, Aruba and Curacao should pay 25% (formerly 35%) of the income tax, wage tax and profit tax to the Central Government. The surcharges are excluded.

The Central Government on the other hand has to transfer 50%

(formerly 45%) of the excise taxes and import duties to the Island Governments of Aruba and Curacao.

The criteria for the distribution of these means between Aruba and Curacao depend on the island where the goods are consumed as far as excise taxes are concerned. With respect to import duties, it depends on the final destination of the goods, as many goods are imported via Curacao. The result of this revenue-sharing regulation is that the island governments of Aruba and Curacao have to turn over on balance to the Central Government.

The tax-sharing is settled six months after the end of the year in which collection takes place, but payment is spread over the last six months of the year following the year of collection.

Both the Central Government and the Island Government of Aruba and Curacao can borrow in the domestic capital market, and from commercial banks. However, only the Central Government is permitted to borrow abroad or from the Central Bank.

In the Netherlands Antilles, we have four types of social security insurances, namely: General Old Age Pensions (A.O.V.), General Widow and Orphans' Pension Act (A.W.W.V.), The Incapacity for Work Insurance Act (O.V.), Sickness Benefit Act (Z.V.).

The contributions of the national insurance (A.O.V. and A.W.W.V.), and employees' insurance (Z.V. and O.V.) in favor of the Social Insurance Bank (S.V.B.) are collected by the Central Government collectors.

The Social Insurance Bank (S.V.B.) and the Central Government have a current account and all deficits of the Social Insurance Bank are covered by the Central Government.

After this short introduction of the fiscal system, I shall dedicate the next paragraph to public finance. As we are mainly talking about the Netherlands Antilles, I decided to highlight the revenue and expenditure scheme of the Central Government only.

1.6.1. Public finance

Over the past five years, the Central Government as well as the Islands Governments have been incurring into large deficits. Public expenditures continuously exceeded public revenues. The Central Bank's annual report of 1980 showed that in 1979 the deficits amounted to Naf. 30 million and in 1979 the deficit decreased to Naf. 13 million. From 1980-1982, the Central Government expenditures went up 50%, whereas their income only increased 26%. Most of these expenditures were for consumption purposes. Table 1.10 gives a representation of the Governments' revenues during 1983 as compared to 1982.

The tax revenues for the Central Government diminished in 1983, because of lower receipts from duties. This decline was caused by lower imports, and the increase in some import tariffs that became effective in mid-November 1983 did not have a significant influence on the total 1983 receipts. Foreign exchange tax rose as the result of an increase in the tariff from .8% to 1.3% in September. The total revenues of the Central Government in 1984 increased, due to large transfers from Aruba and Curacao under the tax sharing arrangement.

Table 1.10. Tax revenues of the Central Government, Aruba and Curacao (in Naf. millions)^a

	Central Government		Aruba		Curacao	
	1982	1983	1982	1983	1982	1983
Income tax	-	-	10	7	34	34
Wage tax	-	-	73	88	188	180
Profit tax	-	-	183	161	286	380
Vehicle tax	-	-	3	4	9	10
Hotel tax	-	-	3	3	1	1
Import duties	108	99	-	-	-	-
Foreign exchange tax	16	17	-	-	-	-
Excise on liquor, beer and tobacco	39	41	-	-	-	-
Excise on gasoline	4	9	-	-	-	-
Other taxes	13	13	4	4	5	4
Total tax receipts	180	178	277	266	523	609
ERNA net	52	97	-	-	-	-
Other	6	15	10	10	21	16
Total revenues	238	290	287	276	544	625

^a Central Bank Quarterly Bulletin, Vol. 4, 1983.

The increase in ERNA (Island Regulation Netherlands Antilles) related revenues of the Government was the fact that Curacao redeemed part of its debt from former years in 1983. Total ERNA receipts in 1983 amounted to Naf. 97 million compared to Naf. 52 million in 1982.

Expenditure, however, increased. Interest payments on domestic

bonds and treasury paper rose from Naf. 9 million to Naf. 24 million. Total personnel costs amounted to Naf. 225 million of which Naf. 30 million had to be laid out for contributions to the pension of retired civil servants. The deficit in 1983 amounted to Naf. 68 million, which was seven million less than in 1982. The Central Government financed this debt by issuing local debt instruments up to the amount of Naf. 16 million (net), an increase of the debt toward the Central Bank, and from interim profit payments from this institution up to the amount of Naf. 21 million. An amount of Naf. 13 million was financed from other sources such as the government account in The Netherlands.

At the end of 1983, domestic debt of the government amounted to Naf. 100 million of short-term treasury paper, Naf. 113 million in bonds, and liabilities to the Central Bank on the advance account amounted to Naf. 99 million; total domestic debt amounted to Naf. 311 million in 1983. The growth in demand for public debt investment declined in 1983. A net amount of Naf. 2 million of treasury paper had to be redeemed by the government and only 18 million could be placed in 1982. The Government received and spent 13 million guilders in Dutch development aid. Seven million guilders went to Bonaire and two million guilders to the three Windward Islands and four million guilders was spent for projects of the Central Government itself. The debt of the Central Government to Holland rose from three million Dutch guilders to 180 million Dutch guilders.

The reasons for these enormous deficits are: high personnel costs

(in the past four years, wages increased by more than 70% despite a personnel-stop decreed in 1979, and salaries are automatically adapted to the cost of living index) and the collection of taxes far behind schedule. The demand for loans also caused the interest rate to rise. To improve the situation, import duties on luxury consumer durables increased and so did the excise tax duties on gasoline, tobacco and alcohol.

In a small open economy like the Netherlands Antilles, deficits of this nature will lead to balance of payment deficits and eventually to a depreciation of the exchange rate which in turn will affect the whole economy. Hence, it will be necessary for the government to cut back on expenditures to prevent the above-mentioned results.

1.7. Summary and Conclusion

Chapter I of this thesis has been written at a point in time that our economy finds itself in a very difficult period. The openness of the economy makes it very vulnerable to exogenous shocks. The depreciation of the Bolivar affected the tourism sector, the inflow of foreign exchange, and the trade sector, and as a result of this several shops closed their doors and laid off people, and revenues of the airline company declined.

A decrease in world demand for oil products affected the oil refinery and as a result of that, Lago (Exxon) shut down its operation in Aruba. This in turn will affect all oil-related businesses in Aruba and

massive unemployment will follow. The government will lose the profit tax paid by Lago each year and will have less income. The decision of the American Congress with respect to the withholding tax law was a severe blow to the offshore financial sector, and consequently, the future of this sector is uncertain and income from this sector as well as expansion of this sector and employment in this sector will surely decrease and so will the inflow of foreign exchange.

The fact that our guilder is pegged to the dollar means that when the dollar is strong, our Antillean guilder is also strong. But on the other side, our products become expensive when compared with other Caribbean, Latin American and European products. As a result, we experience a comparative disadvantage which hampers our exports. A decrease in exports means a decrease in foreign exchange and when producers cannot sell their products, they find themselves with excess inventories. As a result, they will decrease production and lay off excess personnel.

An increase in inflation in the United States induces imported inflation in the Netherlands Antilles. Since wages in the Antilles automatically are adapted to inflation (wage indexation), it causes wages to rise, raising the costs of a factor of production (labor). This has the result of making the Antilles less competitive in the area because while labor costs are rising in the Antilles, in other countries they remain stable or are declining. These high labor costs, the Dismissal Law and the political future of the Netherlands Antilles are making potential investors very reluctant to invest in the Netherlands Antilles.

If, in a situation like this, the government is running high deficits (for consumption purposes), then the situation becomes even worse. In short, we can say that the economic setback is caused by some exogenous factors beyond our control, that will lead to

- 1) increase in labor costs
- 2) increase in unemployment
- 3) decrease in international reserves or foreign exchange
- 4) balance of payment deficits
- 5) decrease in income, standard of living, domestic activity
- 6) decrease in economic growth
- 7) political instability
- 8) massive outflow of capital
- 9) devaluation of the currency

In a situation like this, fiscal policy and monetary policy become necessary tools that must be used together in order to turn the direction of before-mentioned development.

Government expenditures have to be curtailed significantly and certain taxes increased, otherwise fiscal policy will have no effect due to the crowding-out effect. This measure will increase government saving, reduce the balance of payment deficit and these savings should be used for productive investment purposes that will generate employment and income in the long run. In my opinion, the government spent a lot of income on consumption as it is receiving large amounts of foreign

aid for productive investment projects from The Netherlands and the European Economic Community.

As the amount of international reserves is such an important need in an open economy as the Antilles where almost everything has to be imported, controlling the amount of international reserves becomes very important. As a result of this and the fact of a fixed exchange rate system, domestic credit should be observed carefully. An increase in domestic credit will induce a decrease in reserves because as people find themselves with more money, they will want to spend it on goods, and if they can't get the goods domestically, they will be imported. To pay for imports, international reserves will decrease. So domestic credit should be given for productive purposes that will create employment and encourage the export of produced goods.

The export of goods will induce an inflow of foreign exchange and improve the balance of payments. However, it must be said that too many restrictions on the purchase of foreign exchange may lead to a flourishing black market in foreign exchange.

In order to make the Netherlands Antilles competitive again with respect to the surrounding islands and continent, the wages or labor costs have to be reduced. If not, all the leading economic sectors will experience serious setbacks in the near future and the export market will face serious problems in trying to sell its products to other countries.

To prevent the necessity of wage indexation, imports can be brought

in from other countries where the necessary products are cheaper.

In my opinion, to take the economy out of its present state, measures that perhaps are politically unpopular must be taken in order to save our sagging economy.

Footnotes

1. These islands are known as the ABC Islands.
2. The area of St. Maarten is 13 square miles. The southern part with an area of six square miles is Dutch territory, the rest is French.
3. The divi-divi trees show the direction of the prevailing winds.
4. Its best known specimens are the divi-divi, the campeche or brazilwood tree, the aloe, the agave, and several varieties of cactus. Coconut palms, tamarind, guyaba, mango and papaya trees are found in cultivated areas. Halophitic or salt-loving vegetation is represented by the manzanilla tree.
5. The Spaniards imported goats, horses and cattle, and more than one hundred different types of birds are found, the best known being the flamingo or Bonaire and the totolica, a small pigeon.
6. The Windward Islands are 500 miles northeast of the Leeward Islands.
7. Now known as Venezuela, Columbia, Ecuador, Peru and Bolivia.
8. Suriname became independent in 1976.
9. This is done on the responsibility of the ministers. The ministers shall answer to the Staten (parliament of the Netherlands Antilles) for all acts of government. Not one single resolution can emanate from the government without having been countersigned by the ministers responsible for its execution.
10. In the performance of their duties, the judges are independent of the Governor, the ministers and the Staten (parliament of the Netherlands Antilles).
11. Naf. is the short form for Netherlands Antilles guilder.

2. MONETARY FINANCIAL INSTITUTIONS

2.1. Development Process of Commercial Banking System in the Netherlands Antilles

Since the establishment of the Dutch in The Netherlands, these islands have been a transport center. International trade was the main economic activity with the center Curacao. Out of this commercial nature of the island, commercial banks arose. We can say that the commercial banking system as we know it in the Netherlands Antilles nowadays passed through three stages, namely:

- 1) the traditional stage (the colonial situation until the late fifties;
- 2) the period of bank expansion and diversification of activity (1960 until 1969);
- 3) bank concentration, integration and modernization (1969 until now).

2.1.1. The traditional period

In this period, ranging from the colonial time until after the Second World War, banks had as their main purpose the provision of short-term business credit to finance imports, exports and business inventories. According to an annual report of 1936, only Curacao and Aruba had commercial banks.¹

During the thirties, the oil refineries in Curacao and Aruba experienced rapid growth. The transport of machinery, construction material and cement destined for the oil refinery in Venezuela also increased. Consequently, shipping activities in Curacao and Aruba

increased and this growth in economic activity was very beneficial to the islands. Income, purchasing power and the standard of living improved, which in turn proved to be beneficial to the commercial and construction sector. The increase in effective demand for goods and services of the trade sector both domestically and externally made the importance for expansion of the banking system more evident.

The banks that were established in 1932 were the Maduro & Curiels Bank, the Hollandsche Bank Unie, with a branch in Aruba, and the Edwards Henriquez Bank and Co., and in Aruba, the Aruba Bank N.V.

During this period, people saved their money at savings institutions like the Postpaarbank (Postal Savings Bank) and the Spaar en Beleenbank van Curacao.² The total amount of savings at these institutions in 1936 amounted to Naf.1.1 million and Naf.1.0 million, respectively.³ The latter extended loans for consumption purposes with movables as collateral. Their main purpose was the promotion of hoarding of small savers and to prevent the practice of usury. In those days, commercial banks knew their clients very well and were acquainted with the credit-worthiness of their clients. Another institution was the Curacaosche Hypotheek Bank,⁴ established in 1876. During this period, it was the only institution that issued mortgage loans.

However, economic growth in different sectors of the economy led to an increase in the number of banks and an expansion of the banking services into areas that before belonged to other institutions. In short, we can say that the main characteristics of this period are:

- 1) banks only incurred short-term credits for business inventories, import and export,
- 2) savers deposited their money in savings institutions.

2.1.2. Bank expansion and diversification of activities

After the second World War, the nature of the banking system underwent a change and the number of banks continued to grow. This change was reflected in the net worth, current account, time and savings deposits as well as the type of credit extension by banks.

New banks like the Aruba Commercial Bank N.V., Banco Popular Antilliano N.V. (1960), the Windward Island Bank N.V. (1960) and the Caribbean Mercantile Bank (1963) were established. The already-established banks as well as the new ones opened branches and offices on the other islands of the Netherlands Antilles (Bonaire and St. Maarten).

The net worth of Maduro and Curiels Bank N.V. rose from Naf. 2.9 million in 1936 to Naf. 11 million in 1960. The current account deposits increased from Naf. 9.8 million in 1936 to Naf. 24.7 million in 1960. Savings and time deposits amounted to Naf. 21.8 million in 1960 as compared to Naf. 12 million in 1950. The Aruba Bank N.V. and the Aruba Commercial Bank experienced similar tendencies. These developments have been the result of:

- 1) more facilities offered by the commercial banks;
- 2) the savers are upper middle class and upper class people;
- 3) the easiness of transferring money from one account to another;

4) the increase in the standard of living.

At the traditional savings institutions, specializing in attracting funds from small savers, savings also increased. Savings at these institutions in 1960 amounted to Naf. 9.6 million and Naf. 7.6 million, respectively, as compared to Naf. 3.5 million and Naf. 5.4 million in 1950.

Keynes argued that at low levels of income, people's consumption expenditures exceed their income. This is possible as they draw down their savings account. Their consumption function depicts a marginal propensity to consume that is bigger than zero but less than one. In those days, the social security system was not as well-developed as it is now, so people saved their money to be able to meet unforeseen circumstances, or to buy a home or to have some money in their old age. What holds is the implicit assumption, namely, people with higher incomes are able to save a much larger part of their income than do people with lower income. In the period under consideration, the savers that made use of the bank were in general people with high income levels. Nowadays, these phenomena have changed. Banks now have all types of customers, low income and middle income as well as upper income class customers. Another fact is that the upper middle class and upper class people in those days enjoyed higher education and hence were more aware of the cost of money and availability of investment opportunities. Consequently, they invested their money where the return on their investment was highest. The banks in turn used

these obtained funds to fulfill the demand for credit and for investment in foreign securities with a higher yield and less risk due to the absence of a money and capital market in the Netherlands Antilles.

With respect to the extension of medium-term credit transaction, the banks experienced competition from the Curacaosche Hypotheekbank (mortgage bank) and the Bouw Kredietbank and the Spaar en Beleenbank Curacao.

The search for more industrial activities by industrial enterprises during the decade 1950-1960 induced banks to provide their clients with more extensive and diverse financing facilities. One very important aspect of banking is the ability to meet the needs of customers. To be able to realize this, banks began to strengthen the ties with their foreign relations and focused their attention also on the attraction of foreign means.

Thus, the second stage of banking development is characterized by:

- 1) An expansion of banking activities in other areas like savings and time deposits;
- 2) An increase in the competition for loans and savings deposits;
- 3) A higher concentration of banks in the local market;
- 4) The beginning of strong international ties.

2.1.3. Bank concentration, integration and modernization

After 1968, banks expanded their activities to more and more areas that formerly belonged to other institutions, such as the extension

of mortgage loans for residential purposes. Banks also fortified their international relations, and several branches of well-known foreign banks were established in the Netherlands Antilles. For example, in 1969, the Bank of America established a branch in Curacao;⁷ First National City Bank opened a branch in Aruba and the Bank of Nova Scotia opened a branch in St. Maarten. Branches are considered to be an integral part of the parent bank and allowed to offer a full range of banking services like accepting deposits and making loans. The competition that local banks experienced from the new established banks in the credit and deposit market caused some unrest in the market. As a result, the Central Bank intervened and fixed the interest rate on savings accounts at 5% but the interest rate on time deposits was left to the banks and the depositor to decide upon.

In order to maintain a reasonable share of the market, several local banks affiliated with foreign banks. For example, Banco Popular Antillano and Maduro and Curiels Bank Affiliated with Barclays Bank and Bank of Nova Scotia Ltd., respectively. The Hollandsche Bank Unie and later on Edwards Henriquez and Co. Bank N.V. merged with the Algemene Bank Nederland, a Dutch bank.

The acceleration in the establishment of foreign bank branches in the Netherlands Antilles is caused by the tax facilities for non-residents and financial institutions, like mutual funds, financing and trust companies, shipping and free-zone enterprises. Most of these enterprises are from American origin and benefit from the tax agree-

ments between the United States and The Netherlands. It is especially in this time that with the growth of corporate finance subsidiaries, the off-shore finance center in the Netherlands Antilles emerges.

Incorporated as wholly owned subsidiaries of large international firms, the offshore corporate finance subsidiaries were created for the purpose of raising funds from the Eurodollar market or other capital market in the form of bond issues, syndicated loans or direct bank loans. Upon being secured, these funds would be on-lent to the parent firm or other related affiliates.

The rapid expansion of the banking sector, providing all types of services, made the use of computers inevitable. The large banks like Maduro and Curiels Bank and the Algemene Bank Nederland have automatic teller machines, where customers can withdraw money from their bank accounts, make deposits and the like. The former also has a drive-in bank allowing clients to do business from their cars. Nowadays, there are about eleven primary banks with branches or subsidiaries nationwide. Price competition hardly takes place as bank customers pay more attention to the image of the bank and the facilities that the bank offers to them -- for example, can one get consumer loans or a residential mortgage when one has an account with the bank or is this a bank for the big businessman or the poor man or both? Locational convenience also plays an important role. The response, on the part of the bank clients, to a change in the interest rate to attract savers is weak. Nonprice competition is widely used to attract de-

positors. To obtain a larger market share, extensive branching also took place. Maduro and Curiels Bank even has a mobile bank which allows them to reach the rural population and to offer them their banking services.

At this moment, there are only two banks that are completely locally owned, namely, Banco di Caribe N.V. in Curacao and Aruba Bank N.V. in Aruba. All the other deposit institutions are branches or subsidiaries of foreign banks or operated as joint ventures of foreign banks.

With the establishment of foreign banks in the Netherlands Antilles, competition in the market increased, and these foreign branches brought to the Antilles the know-how of modern banking developments and in particular international finance. The banks in the Netherlands Antilles do provide all modern banking services.

On the other hand, there is also a negative side and that is the foreign influence. The fact that the commercial banks are the most important financial intermediaries in the Netherlands Antilles means that the extension of domestic credit is under foreign control and that the profits probably return to the mother bank abroad. Another danger is that a downward trend in economic activity or political instability may induce these banks to leave as the maximization of their profits will be in danger. Thus, maintaining a sound economic environment is a must for the Netherlands Antilles.

2.1.4. Financial intermediaries in the Netherlands Antilles

Financial intermediaries in general sell a particular type of financial service to one group of people and then take the acquired money and sell another type of financial service to another group of people. Since the intermediaries are large, they gain economies of scale in analyzing the creditworthiness of potential borrowers, in processing and collecting loans, and in pooling risks and thus helping individual savers avoid "putting all their financial eggs in one borrower's basket." Specialized intermediaries can enable savings to do more than just draw interest. For instance, putting your money into banks allows you to receive interest and to make payments. Putting your money in life insurance companies provides you both interest and protection against early death.

In the Netherlands Antilles, we can divide the financial intermediaries in two groups:

- 1) monetary financial institutions or primary institutions;
- 2) nonmonetary financial institutions or secondary institutions.⁸

The monetary financial institutions are comprised of:

- 1) commercial banks or deposit banks;
- 2) Giro service;
- 3) offshore business.⁹

These institutions accept deposits and create money by extending credit to their clients. The Giro service does not extend credit to its customers but it does extend credit to the Island Government of Curacao

providing it with liquidity.

The nonmonetary financial institutions or secondary institutions consist of:

- 1) pension funds
- 2) life insurance companies
- 3) credit unions
- 4) Ontwikkelings Bank van de Nederlandse Antillen
(Development Bank)

These institutions do not create money but merely transfer money from suppliers to those who need it. They don't have demand deposits.

Banks, as is true of all credit institutions and associations, must register with the Central Bank. To start a business, a Declaration of No Objection is required from the Central Bank. The latter must issue such a declaration unless the issuance of such declaration is detrimental to the development of a sound banking and credit system or in conflict with sound banking policy. Credit institutions are defined as enterprises or institutions, with the exception of credit associations, which substantially are making their business to accept moneys and/or to grant credit facilities. Credit associations are defined as institutions whose purpose is to assist their members in saving and/or to grant credit and advances to such members. Next, I shall describe each one of these intermediaries in the Netherlands Antilles.

2.1.5. Commercial banks

Commercial banks are the traditional "department stores" of finance, serving a wide variety of savers and those with needs for funds. They can be considered the major institutions which handle checking accounts and through which the Central Bank expands or contracts the money supply. In the Netherlands Antilles, banks are the largest financial intermediaries as a result of the wide dispersal of savings deposits among the population and the relatively large size of savings deposit in relation to the commercial bank's total domestic liability.

The main business of commercial banks in the Netherlands Antilles is short-term lending for commerce, construction and consumption.

Most of their liabilities consist of:

- 1) demand deposits,
- 2) time deposits,
- 3) savings deposits.

The nature of banks in the Netherlands Antilles is oligopolistic. Oligopoly is said to exist when more than one seller is in the market, but when the number is not so large as to render negligible the contribution of each.

There are 13 basic banks with subsidiaries or branches nationwide (see Appendix 1). Some of these banks are the owner of mortgage banks or finance companies.

Within these 13 banks, Maduro and Curiels Bank can be considered

a lead bank. This bank, in 1984, had 65% of total domestic assets of all commercial banks together.

The local deposit banks are allowed to deal with residents and nonresidents. The offshore banks, however, are only allowed to render services to nonresidents.¹⁰

2.1.6. Sources and uses of bank funds

The activities of bankers can be classified into sources and uses of funds. If an increase in an item increases a bank's cash, then the item is a source of funds to the bank. However, if an increase in the item decreases the bank's cash, then it is a use of bank funds. An increase in an uncontrollable balance sheet item like deposits, capital and reserves is a source of funds and the reverse is also true. Thus, liabilities and resources vary in the same direction, but assets and bank resources vary in opposite directions. Hence, a decrease in outstanding loans (asset) means an increase in bank resources, and an increase in loans is a use of funds or a decrease in resources.

If we look at Table 2.1, we see that government deposits at commercial banks fluctuated a little bit, but deposits of the private sector increased from Naf. 770.6 million in 1980 to Naf. 1,090.2 million in 1984, which implies an increase in available sources of commercial banks by 41%. Capital and reserves jumped from Naf. 81.1 million in 1980 to Naf. 135 million in 1984. Table 2.1 shows that total deposits kept growing, but a breakdown of deposits at commercial

Table 2.1. Commercial bank summary account (in Naf. millions)^a

	End of:	1980	1981	1982	1983	1984
<u>Assets:</u>						
Liquid assets:		89.6	77.5	23.0	65.8	47.2
Loans to public sector		58.9	69.7	109.8	99.0	99.3
Loans to private sector		716.7	861.0	956.0	1,090.8	1,100.8
Total domestic assets		865.2	1,008.2	1,088.8	1,254.8	1,247.3
Net foreign assets		35.1	56.7	57.7	49.0	62.8
Total Assets		900.3	1,064.9	1,216.5	1,304.8	1,310.1
<u>Liabilities:</u>						
Deposits:						
Central Government		7.5	5.7	7.2	7.0	6.8
Island Government		19.1	58.3	55.0	67.4	48.7
Private sector		770.6	869.1	1,011.9	1,074.8	1,090.2
Capital and reserves		81.1	95.2	105.8	116.9	135.0
Miscellaneous net		21.9	36.5	36.6	38.7	29.3
Domestic liability		900.3	1,064.9	1,216.5	1,304.8	1,310.1

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

banks shows that the growth rate declined or remained constant as is the case in savings. Table 2.2 gives a breakdown. Demand and time deposits declined in 1983 and 1984. The growth rate in savings deposits declined from 18% in 1982 to 4% in 1983 and remained constant at 4% in 1984.

Table 2.2. Breakdown of commercial bank deposits in millions Naf.^a

	1980	Δ%	1981	Δ%	1982	Δ%	1983	Δ%	1984
<u>Liabilities</u>									
Deposits:									
Demand	183.1	8	197.8	21	239.7	-.4	238.6	-9	218.1
Time	58.6	17	68.7	38	94.9	22	115.8	-2	113.4
Savings	438.9	12	492.1	18	579.1	4	603.1	4	624.9

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

This development in deposits is due to the decline in economic activity in 1983 and 1984 (see paragraph 1.5.1, sectoral development). Hence, a decline in the amount people used to save, and the decline in demand and time deposits, as a result of a decline in income.

Another typical characteristic of savings deposits at the deposit institutions is that these deposits are withdrawable on demand. Many banks don't have withdrawal conditions on checking accounts and savings deposits. Hence, savings accounts are used as current accounts even though the withdrawal and transfer cannot occur by way of check. Consequently, savings deposits in the Netherlands Antilles have a high rate of turnover or velocity and the average number of months that a deposit (savings) has is 14 or 15 months as Table 2.3 shows. This nature of savings deposits, the largest source of fund of commercial banks, constrains the deposit banks to make long-term loans.

The interest rate paid by most banks on savings deposits is 5%,

Table 2.3. Savings deposits at commercial banks^a

	End of:	1980	1981	1982	1983	1984
Outstanding amount		575.8	664.1	734.9	785.8	816.9
Number of accounts (x1000)		189.5	204.4	204.9	216.3	224.8
Average balance in Naf.		303.8	324.8	358.6	363.3	363.4
Velocity of circulation		.80	.86	.84	.86	.81
Average term of rest in months		15	15	14	14	15

^a Central Bank Quarterly Bulletin, Vol. 4, 1984.

although Banco Caribe N.V. pays 6.25%. At the end of 1984, the commercial banks, excluding the commercial banks' offshore departments, had on average 225 thousand savings accounts outstanding. Most time deposits have a maturity of less than a year and the maximum time span is five years. This nature of time deposits reinforces the fore-mentioned constraint on long-term loans. The minimum amount required for a time deposit varies from Naf. 5,000 to Naf. 10,000.

The interest rate on time deposits is flexible and for amounts larger than Naf. 10,000, the interest rate is determined by negotiation between the depositor and the bank. What also deserves some attention are the international transactions of the deposit banks, which exceed the domestic transactions as is shown in Table 2.4. In 1984, total foreign assets comprised 63% out of total assets. In 1982, this percentage was 82%. Bankers in the Netherlands Antilles invest their

Table 2.4. Consolidated balance sheet of commercial banks (in millions Naf.)^a

	1980	1981	1982	1983	1984
Total domestic assets	956.8	1,122.7	1,276.0	1,373.7	1,383.6
Total foreign assets	4,741.4	5,499.3	6,014.2	4,425.9	2,396.5

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

funds in the American stock market due to lack of investment projects in the Antilles and absence of a local money or capital market. In this way, banks obtain a higher yield on their investment and reduce the risk. However, regulation of the Central Bank caused this percentage to decrease. The net foreign asset position of commercial banks may at no time be negative without prior consent of the Central Bank.

On the asset side of the commercial balance sheet, loans deserve attention. Loans can be divided into long-term, medium-term, and short-term loans. Due to the nature of savings deposits (withdrawable on demand) and the nature of time deposits (less than a year), the commercial banks make short-term loans and no long-term loans. Most of these loans are made to the commercial sector to finance imports, exports, and business inventories as Table 2.5 shows. A significant part of these loans go to individuals and are used for consumption purposes like the buying of durable consumer goods. A much smaller amount is extended to the manufacturing sector.

The devaluation of the Venezuelan bolivar affected the trade

Table 2.5. Commercial banks' loans to private sector (in millions Naf.)^a

	Nov. 1980	Nov. 1981	Nov. 1982	Nov. 1983	Nov. 1984
Manufacturing	39.4	49.3	81.9	115.8	116.9
Electricity, gas and water	42.6	48.6	41.9	37.0	37.7
Construction	36.6	32.5	333.1	26.8	29.9
Trade	307.8	334.8	351.4	376.1	361.5
Hotels and restaurants	25.3	38.3	37.8	60.3	58.9
Transport, storage and communication	26.2	30.4	21.4	17.0	24.2
Financing, insurance and real estate	36.4	37.4	45.6	56.4	63.6
Other services	19.5	26.4	33.3	33.4	36.2
Individuals	192.5	253.1	286.8	318.7	326.2

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

sector, causing a decline in the number of Venezuelan tourists that visited especially Curacao and Aruba. As a result, many stores had to close down operations but others remained in business facing a sharp drop in demand for their products. This in turn affected the demand for loans and from Table 2.5, we see that loans to the trade sector dropped from Naf. 376.1 million in November 1983 to Naf. 361.5 million in November 1984, a slight decrease of 4%.

However, banks provided to many businessmen in good standing financial advice and support in order to maintain them in business.

Table 2.6 shows that 35.2% out of total loans to the private sector goes to wholesale and retail trade to finance commerce. Loans to individuals for consumption purposes comprised 29.7% and loans to manufacturing and agriculture comprised 10.3 and .1%, respectively. In general, this is a common behavior of commercial banks as these financial institutions tend to search avenues of employment for the funds they attract that maximize their profits; for example, where interest earned is high and the risk of nonrepayment small. Deposit banks tend to have a "demand-following" approach.¹¹

The Central Bank has been trying to direct the flow of funds of commercial banks toward productive investments by using selective credit controls on consumer credits because economic activity has been declining and the country has a balance of payment deficit and a high unemployment rate. This has been a very good incentive of the Central Bank. However, a simple restriction on consumer credit to stop it from growing beyond the target limit will not in itself force banks to direct their loans to those areas that will create more employment, especially when the risk is a bit high. What has to be done is for the government to reduce the deficits. This will create more stability and confidence in the financial sector as the higher the deficit, the more reluctant prospective investors become to invest. Then, the government should determine the areas of "high priority." Then, to-

Table 2.6. Breakdown of commercial banks' loans to domestic sectors by kind of economic activity per the end of May 1984

Sector	Loans outstanding		
	Current account	Term loans	Mortgages
<u>Loans to the private sector</u>			
a) Enterprises			
Agriculture: Forestry and fishing	1.1	0.2	0.1
Mining	-	-	-
Manufacturing	50.2	53.9	2.4
Food, beverages and tobacco	4.1	1.3	2.0
Textiles and leather products	2.1	0.1	-
Wood and wood products	2.7	-	-
Paper, printing and publishing	10.8	5.2	0.2
Chemicals and petroleum products	13.8	45.9	-
Ceramics	0.3	-	-
Basic metal industries	13.3	0.8	0.2
Other manufacturing industries	3.1	0.6	-
Electricity, gas and water	7.9	26.0	0.3
Construction	23.4	6.3	3.5
Wholesale and retail trade	296.5	50.9	15.4
Restaurants and hotels	21.0	8.5	19.7
Transport, storage and communication	17.1	2.7	2.8
Financing, insurance, real estate and business services	31.5	19.1	6.8
Other services	14.3	19.7	2.4
Activities not adequately defined	2.7	0.2	0.3
Subtotal	465.7	187.5	53.7
b) Individuals	19.3	107.5	180.0
TOTAL LOANS TO THE PRIVATE SECTOR ^a	485.0	295.0	233.7
<u>Loans to the Public Sector</u>			
a) Central Government	0.2	9.4	-
b) Island Governments	7.3	1.6	-
TOTAL LOANS TO DOMESTIC SECTORS	492.5	306.0	233.7

^aIncluding special loans, not including amounts receivables.

Total	Percentages			Percentage of total loans
	Current account	Term loans	Mortgages	
1.4	0.2	0.1	-	0.1
-	-	-	-	-
106.5	10.2	17.6	1.1	10.3
7.4	0.8	0.4	0.9	0.7
2.2	0.4	-	-	0.2
2.7	0.6	-	-	0.3
16.2	2.2	1.7	0.1	1.5
59.7	2.8	15.0	-	5.8
0.3	0.1	-	-	-
14.3	2.7	0.3	0.1	1.4
3.7	0.6	0.2	-	0.4
34.2	1.6	8.5	0.1	3.3
33.2	4.8	2.1	1.5	3.2
362.8	60.2	16.6	6.6	35.2
49.2	4.3	2.8	8.5	4.8
22.6	3.5	0.9	1.2	2.2
57.4	6.4	6.2	2.9	5.6
36.4	2.9	6.4	1.0	3.5
3.2	0.5	0.1	0.1	0.3
706.9	94.6	61.3	23.0	68.5
306.8	3.9	35.1	77.0	29.7
1,013.7	98.5	96.4	100.0	98.2
9.6	-	3.1	-	0.9
8.9	1.5	0.5	-	0.9
1,032.2	100.0	100.0	100.0	100.0

gether with the Development Bank (Ontwikkelings Bank van de Nederlandse Antillen), the deposit institutions can be urged to divert their funds from "low priority" areas into the "high priority" areas. The advantage is the Development Bank has the expertise to assess the creditworthiness of these sectors as well as the long-run socio-economic contributions of projects within these sectors to the Netherlands Antilles, and the feasibility of these projects from an economic viewpoint.

The weakness of the Central Bank in attempting to direct credit is that they don't analyze the productive investment projects. Consequently, it depends on the goodwill of commercial banks whether they invest their funds into the required areas (productive investment). The problem is that commercial banks are profit maximizers, hence, they observe variables like risk, uncertainty and interest and profit very carefully. Projects that they will carry out must be commercially viable. Now, the Development Bank has the expertise to assess projects and to do economic analysis. Moreover, the government and the four big commercial banks are shareholders in the Development Bank of the Netherlands Antilles. This may lead to a midway and the high risk aversion and conservative approach of local bankers may be tempered.

Further economic decline is not desired as in the long run it will also affect commercial bank sources of funds as national income will decline and savings will decline. From the viewpoint of controlling reserves (international) restricting consumer credit was certainly beneficial, because if with a deficit of Naf. 90 million,

in 1983, bank credit for consumption purposes also increases, then international reserves will decline, because in a small open economy, with little natural resources, and insignificant domestic production any credit and monetary expansion in excess of the optimum will lead to an excess domestic demand that will be covered by excess imports and in a shortfall in the actual monetary expansion matched by a depletion of international reserves. In a small country like the Netherlands Antilles, the maintenance of the external stability of the currency, including the maintenance of an adequate level of international reserves must be regarded as a prerequisite for the development and maintenance of a sound monetary system.

Hence, the Central Bank, in 1983, imposed restrictions on consumer credit. These credits, beginning October 31, 1983, are not allowed to increase. Table 2.7 gives a breakdown of consumption and production loans to the private sector.

Table 2.7. Credits of commercial banks to the private sector^a

	1980		1981		1982		1983		1984	
	outst.	%	outst.	%	outst.	%	outst.	%	outst.	%
Loans to enterprises	499	8	585	17	620	6	746	20	754	1
Mortgage loans	104	49	129	24	150	16	158	5	165	4
Consumptive credit	104	8	125	20	152	22	138	-9	124	-10
Total credit	707	12	839	19	922	10	1042	13	1043	0

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

From Table 2.7, we notice that from 1980 up to 1982 consumption credit was growing much faster than production credit, even when taking into account the inflation rate. With the selective control measures of the Central Bank, in 1983 the growth rate of the former reversed.

In 1984, the economy was still not out of the recession. Government revenues fell short of expenditures, and there was a balance of payment deficit of Naf. 70 million. In this period, consumptive credit declined by 10% and investment rose by only 1% as compared to 20% in 1983. Mortgage loans rose by 4%.

These facts indicate the prudence of commercial banks. In the Netherlands Antilles, banks are not venturesome but tend to be conservative and risk averse. The high deficits are also not encouraging for prospective investors. Moreover, the high demand for loans to finance the deficit will drive up the interest rate and discourage investment.

The sale of treasury paper is not used for monetary purposes but to finance deficits, and development aid from the Netherlands and the European Economic Commission is used in productive investment projects.

2.1.7. Inter-bank relations

A banking system consists of individual banks and in most countries, they have dealings with one another in their day-to-day operations. In the Netherlands Antilles, this is somewhat different. Banks have very little contact with one another. They almost operate as unit banks and have sufficient liquidity to provide their customers

loans to take care of their daily operations.

Coins and currency are provided by the treasury via the Central Bank. When commercial banks have excess liquidity, the amount over and above what they need for their daily operations are transferred to a time deposit at the Central Bank on which they receive interest that varies between 4-1/2 to 6% depending on the timespan of the deposit.

2.1.8. Clearing and collection

Clearing and collection of checks refers to a system wherein reciprocal amounts of checks are offset against one another and where only the net differences are paid, or collected. This process in the Netherlands Antilles is done at the clearing desk of the Central Bank. Every working day at eleven o'clock in the morning, representatives of the banks in question meet at the before-mentioned clearing desk of the Central Bank to exchange the debit and credit items.

This clearing occurs on the basis of mutual confidence and the items received are not verified but for the number. Possible mistakes and unpaid checks are brought in the next day and the clearing is done by means of a transfer note. Now by Agreement of May 1974, banks have a current account at the Central Bank on which each individual bank holds an amount that equals 10% of its domestic liability payable at demand, and the claims and liabilities of the different banks are settled on these accounts at the Central Bank. The latter, however, does not participate in the clearing process.

There is no inter-bank loan market in the Netherlands Antilles, where surplus banks loan their excess funds on an overnight basis to deficit banks. Most of the time, if a bank needs funds it can get these funds from one of its branches either in the island or at a branch on one of the other islands.

2.1.9. Foreign exchange

All the local commercial banks are authorized by the Central Bank to deal in foreign exchange currencies. When dealing with the public, they have to apply for the official rates. In dealing with the deposit banks, the Central Bank mainly deals in U.S. dollars at the interbank rate of Naf. 1.80 for one dollar. Residents must hand over exchange proceeds to an authorized bank. However, although a must, this provision is very flexible when interpreted by the authorities in order to accommodate tourism. Hence, residents are allowed to have some foreign currencies in cash to meet exchange problems arising from payments made by tourists. Resident enterprises are also allowed to hold accounts at the deposit banks that are expressed in foreign currencies and the commercial banks also provide loans and overdrafts in foreign currencies, mainly in U.S. dollars. Payment for legally imported and exported goods can be made freely under a General License from the Central Bank.

Bankers usually communicate with one another through the Bankers Associations, set up in Aruba as well as Curacao and of which all the local primary banks are members. These associations, however, don't

represent the banking community vis-a-vis the government, nor can they be considered a cartel organization, and they also don't fix interest rates, fees and other charges. Usually, they meet periodically to discuss subjects like opening hours and bank holidays.

We can conclude that the Netherlands Antilles have a very well-developed commercial banking system and that notwithstanding the economic malaise of 1983 and 1984, commercial banks' assets and capital kept growing. The banking system is very sound, but risk averse and conservative and concentrates heavily on short-term loans (self-liquidating) to finance commerce (imports, exports, business inventories). Medium-term and long-term loans to finance manufacturing and agriculture or industry have been neglected due to the nature (short term) of their liabilities (deposits) and liquidity requirements of the Central Bank (see Chapter 3) and the lack of locally productive investment opportunities. The main source of funds is savings deposits. But the high velocity of the latter constrains the commercial banks in making long-term loans.

2.2. Offshore Banks

Before 1945, banking used to be a domestic enterprise. After the second World War, an international financial community emerged first to furnish the capital to rebuild a war-torn Europe and later on to contribute to other aspects of the developing international commerce.

International financial centers used to be extensions of existing domestic centers as the trained personnel and communications net-

work were already present in domestic centers. The most important centers for international finance were London and New York. However, after 1970, other areas not known for their existing banking facilities grew to become important centers for international banking on account of favorable regulatory and taxation policies. Among these newly developed centers, in the mid-1960s with the growth of corporate financial subsidiaries, the Netherlands Antilles emerged as one of the most sophisticated offshore investment centers in the Caribbean area.

Offshore banking is a term usually applied in banking transactions between foreign borrowers and foreign lenders. The purpose is to facilitate international transfers of funds in a business environment supportive of that goal. Many times they have been created to hold ownershipshares in foreign companies and real estate enterprises and to hold rights to patents, royalties and copyrights.

The possibility for the Netherlands Antilles to become an offshore center was created by means of an income tax treaty between the United States and the Netherlands, concluded on April 29, 1949 in Washington, and extended to the Netherlands Antilles in 1954. Consequently, a revision of the Antillean profit tax ordinance took place whereby net income out of dividends, interest, royalties, etc., of a number of companies (investment, holding, finance, royalty, real estate, copyrights companies) would be subject to a very low tax rate of 2.4-3%¹² (2.4% on the first Naf. 100,000 net profit and 3% on the

remainder). These rates have been guaranteed by law until the year two thousand. Moreover, under the current tax treaty between the United States and the Netherlands Antilles, an American offshore financing company registered in Curacao is exempted from the 30% withholding tax on the interest paid by the U.S. parent to the Netherlands Antilles subsidiary.

Income from local operations is subject to the standard rates of 27 to 34% and there is also a municipal surcharge of 15%. This special tax treatment, together with the tax treaties concluded with the United States, the United Kingdom and The Netherlands, allowed the Netherlands Antilles to become an attractive offshore center.

Other factors that contributed to the growth of the latter are:

- 1) the political stability;
- 2) the superb infra-structure;
- 3) the excellent telecommunication network with the rest of the world, especially Curacao;
- 4) the good reputation of the Netherlands Antilles as compared to the zero tax-havens in other places;
- 5) the liberal foreign exchange regulations;
- 6) the supply of professional services of bankers, lawyers, accountants as well as broker services offered by banks;
- 7) the living climate in the Netherlands Antilles.

These factors allowed the Netherlands Antilles to serve the purpose of being an intermediary. Via the Antilles, the wholly owned

subsidiaries of large international firms could raise funds from the Eurocurrency or other external capital, in the form of bond issues, syndicated loans or direct bank loans. Upon being secured, these funds would be on-lent to the parent firm or other related affiliate. Hence, this route became known as the "Antillen Route." A numerical example will make it clear why it was so important for American firms to use this route.

Suppose that a financial subsidiary in the Netherlands Antilles borrows \$100,000 from the Eurocurrency market at an interest rate of 14% and in turn lends the funds to the parent firm in the United States at a rate of 15%. The interest gain will be 1%. Now, suppose that the funds are held for one year. After a year, the parent firm pays the finance subsidiary \$100,000 (the nominal amount) plus 15% interest, which amounts to 15,000. In other words, the finance subsidiary receives \$115,000. The latter then pays the lender in Europe \$114,000 (interest-plus nominal value) and its net profit is \$1,000.

Without the tax treaty, the finance subsidiary would have a tax liability to the United States of 30% of \$15,000 gross interest which amounts to \$4,500.

Under the provision of the treaty, the finance subsidiary has no tax liability to the United States, but is only subject to a Netherlands Antilles profit tax of \$300 (assuming a 30% profit tax rate over a net profit of \$1,000). Hence, the consolidated corporation pays a total tax amounting to only 6.7% of what would have been paid in absence

of a tax treaty. In addition, the parent firm may also receive credit against U.S. tax liabilities for tax payments made to the Netherlands Antilles (Mathieson and Laudicina, 1982).

Thus, the biggest advantage of the Netherlands Antilles has been the possibility to use tax treaties. The two most important ones were: the one with the United States and Holland, or The Netherlands.

Another advantage is that the stockholder's name does not appear on the certificate. This is done to protect the client. For instance, a managing Director of a huge enterprise in England would like to keep the extent of his wealth secret, not to escape tax perhaps but to prevent that someone of his family be kidnapped by a terrorist group.

The seat of the offshore business in the Netherlands Antilles is situated on the Island of Curacao. Ninety-five percent of all offshore companies are there.

The macroeconomic consequences of this sector are significant. First, this sector generates enormous amounts of foreign exchange which is of vital importance for the Netherlands Antilles. Without foreign exchange, the trade sector, for instance, would come to a standstill. Almost everything in the Antilles is imported. Figure 2.1 shows the foreign exchange contribution of the offshore sector. It is estimated that the number of people employed in the offshore sector lies between 1,300 and 1,400 people, and about 4,000 workers in the private sector and public sector, mainly in Curacao, depend directly or indirectly on the offshore sector for employment.

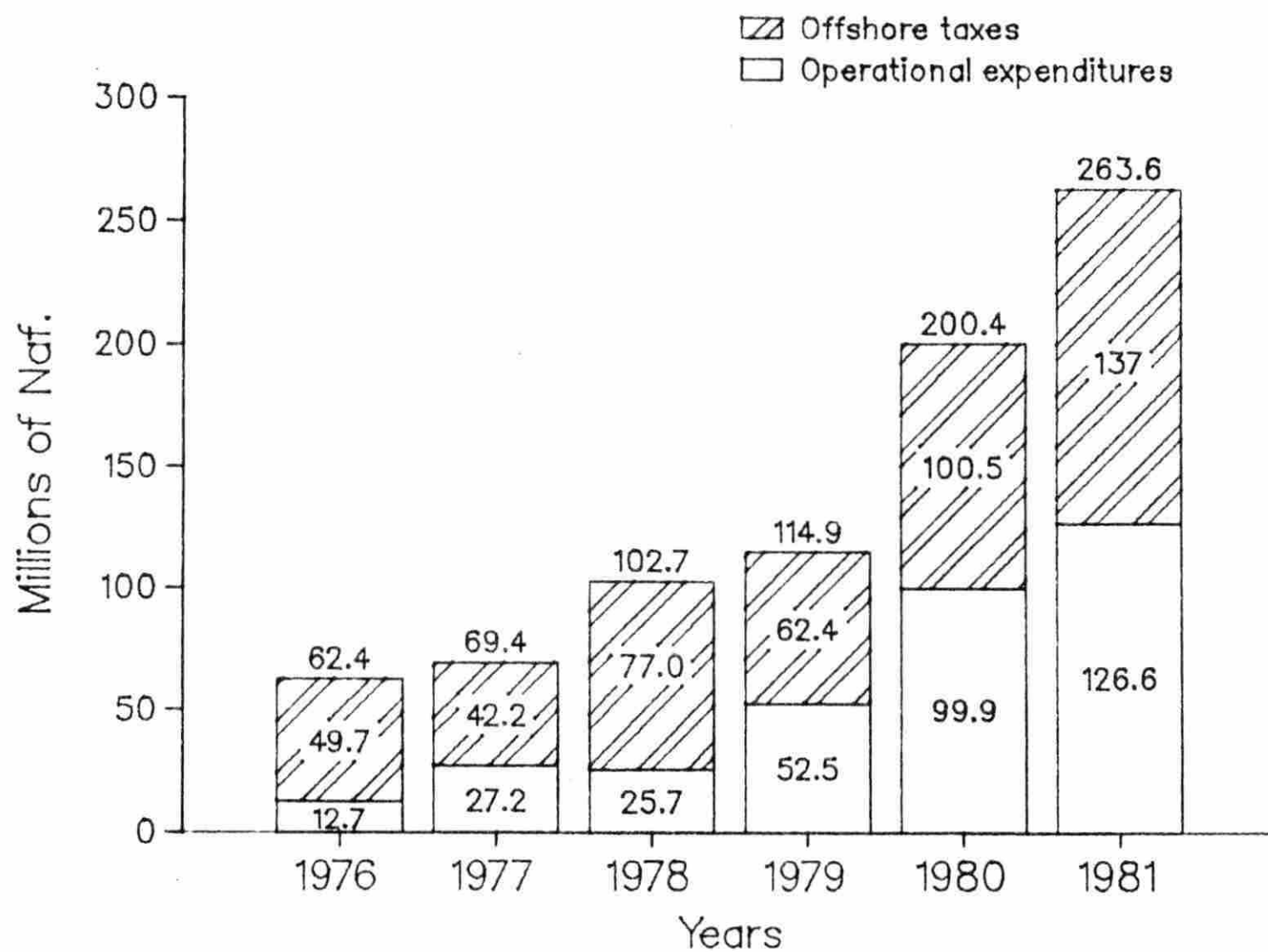


Figure 2.1. Foreign exchange contribution of the offshore sector (Naf. millions)

A survey of the Stanford Research Institute International, in 1982, showed that of the full-time employees in this sector, 792 were Netherlands Antilles nationals and 130 were foreign nationals. Assuming that all part-time employees are Antillean, the total employment for citizens of the Netherlands Antilles is 807, or some 86% of the total. The survey also showed that employment in the offshore sector has grown consistently since the mid-1970s by an average of about 16% annually. Figure 2.1 shows the growth in employment. Government revenues increased enormously due to the profit tax received from the offshore sector. Sixty percent of total offshore taxes assessed are made on financial activities related to the U.S. Netherlands Antilles tax treaty. Figure 2.3 shows the growth of total offshore tax revenue that the government received.

From Table 2.8, we notice that revenues from the profit tax exceed all other government revenues and that the share of offshore profit tax in total profit tax is considerable. In 1982, 42% of the total profit tax came from the offshore sector. In 1983, 54% of profit tax paid to the government belonged to the offshore sector. With 95% of all offshore activity on the Island of Curacao, the latter has become the largest recipient of offshore taxes as Table 2.9 indicates.

2.2.1. Recent developments in the offshore sector

The offshore sector has become an important pillar of our economy, and it would be desirable if this sector could keep on growing at an increasing rate.

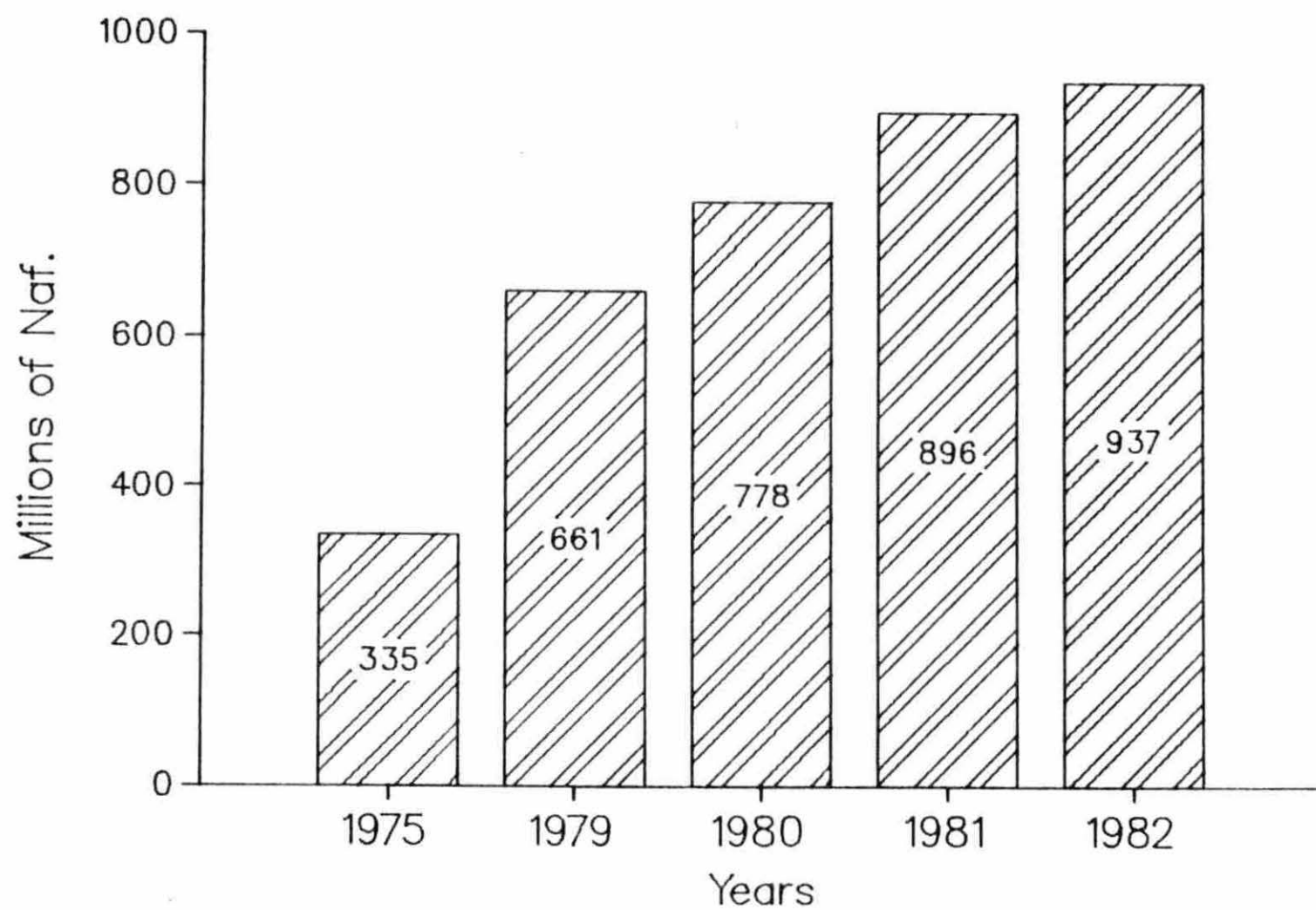


Figure 2.2. Employment growth in the offshore sector

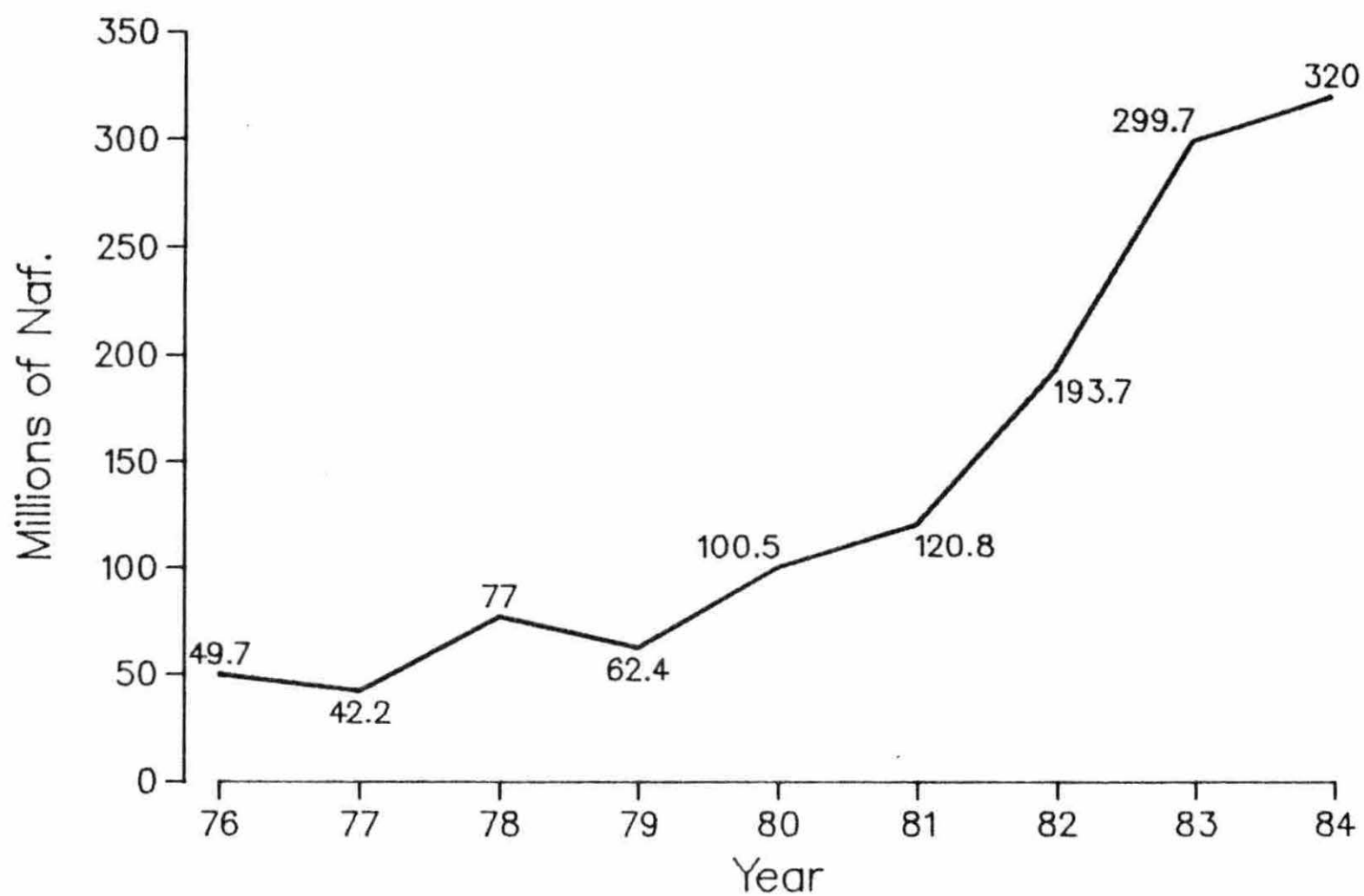


Figure 2.3. Growth of total offshore tax revenue (Naf. millions)

Table 2.8. Tax and other receipts of the government^{a,b} (Naf. millions)

	1980	1981	1982	1983 ^c
Taxes on income and profits	489.7	659.7	787.3	886.0
Income tax	59.2	47.5	46.2	45.7
Wage tax	201.5	266.6	281.0	290.5
Profit tax (total)	229.0	345.6	459.7	549.7
(from offshore)	(100.5)	(120.8)	(193.7)	(299.4)
Taxes on property	37.1	15.1	26.1	14.5
Excise tax	68.7	71.8	72.7	79.8
Taxes on international transactions	85.7	101.6	121.0	112.7
Other tax receipts	17.4	90.7	85.7	77.5
Total tax receipts	698.7	938.9	1,092.9	1,170.5

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.^bCentral and Island Governments.^cPreliminary figures.Table 2.9. Offshore tax receipts by area^a (Naf. in millions)

	Aruba		Curacao		Bonaire		Windward Islands	
	1982	1983 ^b	1982	1983 ^b	1982	1983 ^b	1982	1983 ^b
Offshore tax receipts	2.1	7.2	189.8	290.7	-	-	-	-

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.^bPreliminary data.

However, dark clouds gathered in the sky above the Netherlands Antilles. In the United States, there are two types of withholding taxes: one on interest and another one on dividends. Over time, the United States was considering the possibility of eliminating the withholding tax on interest. Pressure within the United States to eliminate the latter came from the government, corporations and Wall Street firms.

The United States government dependence on foreign capital to finance the huge budget deficits made the Treasury push very hard for the repeal of the withholding tax on interest paid to foreign investors. Their arguments were that the latter could lead to greater foreign demand and perhaps lower interest rates for the Treasury.

Corporations that wished to ensure their access to the Eurobond market were in favor of the repeal as they were afraid that renegotiation of the tax treaty between the United States and the Antilles would lead to the treaty being terminated.

In mid-July 1984, the United States House and Senate conferees decided to repeal the 30% withholding tax on interest paid to foreign investors in United States securities and to leave the withholding tax on dividends. This repeal of the withholding tax for foreign investors in the United States was like an ice cold shower on the financial offshore sector and the tax collector of the Island of Curacao. The bonds that have been issued via the Netherlands Antilles before the decision of the House and the Senate will fall under the old regulations, allow-

ing the Netherlands Antilles a grace period of more or less seven years.

In the same year, 1984, The Netherlands, under pressure of the United States, West Germany and Italy with whom they have a tax treaty, decided to make some changes in its treaty with the Netherlands Antilles. These countries allege that they are deprived of tax revenues because residents of countries with whom there are no tax treaties escape the tax on dividends, interests, and royalties in their country by making use of the Dutch tax treaties and other tax regulations in The Netherlands. These funds then leave the country, almost free of tax, to the Netherlands Antilles where they are subject to a 2.4-3% tariff. Hence, The Netherlands made some changes in the tax laws. In the future, all companies using the Holland-Netherlands Antilles route will pay more tax than before.

Formerly, Holland charged a dividend tax of 25%. If a subsidiary from a Dutch company in the Netherlands Antilles received the dividend, then the dividend tax to be paid was reduced to 15%. In the Netherlands Antilles, the subsidiary, depending on the income, would be subject to 2.4-3% tax rate.

If the subsidiary in the Netherlands Antilles held 25% of the stocks of the company in Holland (The Netherlands), then the withholding tax on dividends was reduced from 15% to 0%. This 0% has been changed to 7.5%. This 7.5% will be reduced to 5% if the Antilles has increased its tax from 3 to 5.5%. Consequently, the total tax in these dividends

payments will be 10.5%.

Another development that also affected the offshore sector is the future political structure of the Netherlands Antilles. In 1986, the Island of Aruba, that is now a part of the Netherlands Antilles, will become a separate state (known as "Status Aparte") under the leadership of Betico Croes, leader of the largest political party of Aruba. This implies that the Netherlands Antilles, in the future, will consist of five islands instead of six. How the Netherlands Antilles as a group of five islands will develop is uncertain: it will depend on the efforts of the government to guide the country in the right direction and maintain the political stability that is so important for the investment climate. The island of Aruba, in 1986, will have its own government and own central bank.

2.2.2. Impact of recent developments on the economy in the future

By repealing the withholding tax on interests, the United States' corporations don't need the Netherlands Antilles any more to do business in the Eurodollar market. They can do it now directly because the main reason for using the Antilles was the gains they made (see example on page 69). As a result of this decision, the government of Curacao will lose between \$120 million and \$180 million in revenues. It will not mean the end of the offshore sector but a substantial setback will be the result. Foreign exchange receipts will also decline. A decline in the offshore international transactions will force offshore banks and trust companies to reduce their level of activity, go out of busi-

ness, or move to another country. In all these cases, this implies a lay off in personnel not only in the offshore sector but in all other activities that benefitted from these financial offshore businesses.

The decrease in government revenue will be reinforced by the fact that Aruba will receive its "Status Aparte" and consequently does not have to pay the Central Government 25% of the income tax, wage tax and profit tax, as established in the revenue sharing agreement (see Chapter I: The Fiscal System of the Netherlands Antilles).

In the worst situation, this decrease in government revenues may trickle down to other areas that heavily depend on the government, for instance, the quasi government corporations. It may also have socio-economic consequences, for instance, the government may have to cut back on expenses for health care, university education, subsidies for housing projects for the poor, as well as the transfers to the Island Governments (Bonaire, Windward Islands).

In short, 1984 meant a turning point for the flourishing financial offshore sector. Other offshore activities (see Appendix II) still take place, but they will not generate those huge profit tax amounts to the government. Experts also believe that automatization, in the offshore sector, will take place as it seems that offshore activities in the Netherlands Antilles are more expensive than in other offshore centers in the Caribbean. To keep the offshore business alive, new activities will have to be developed. The decrease in this sector will cause

national income to decline over time.

2.2.3. Future developments in offshore

Future opportunities for the offshore business is to attract a Foreign Sales Corporation (FSC). These companies must maintain an office outside the U.S. territory, maintain a summary of its permanent books of account at its foreign office, have at least one director who is a resident outside the U.S.A., and must be incorporated outside the United States (Antillen Review, 1984).

If the above mentioned requirements also included that an FSC should be incorporated in a country with which the U.S.A. has concluded a tax-treaty, then the Netherlands Antilles would surely be an attractive location for Foreign Sales Corporations as there already exists a tax treaty between the U.S.A. and the Netherlands Antilles.

A proposal under consideration in the Netherlands Antilles, to broaden the legislation concerning the registration of ships, also will bring some relief to the offshore sector.

The shipping companies that have ships sailing under the Antillean flag do have to pay a withholding tax on the profits they make. The before-mentioned proposal offers the companies a choice. They can choose between paying the withholding tax or paying a fixed rate per registered gross tonnage.

Experts believe that many companies will prefer to pay the fixed rate since it allows for a more certain calculation of costs.

Expectations are that once this proposal is passed into law, a

reasonable number of shipping companies registered in Panama and Liberia will come to the Netherlands Antilles. Another advantage is that these companies can make use of the Curacao Drydock Company, which is one of the best in the Caribbean. From a macro viewpoint, these companies will generate more employment opportunities and income for the government, and as a result, the economy might start growing again. Another proposal is to set up and run an offshore stock exchange where international capital transactions can take place and which will give more content and international reputation to the offshore sector, and this may stimulate the private sector and prospective investors to issue shares and bonds.

2.3. Giroservice

The Giroservice was established in 1965 on the Island of Curacao and can be compared to the Giroservice in the Netherlands and the National Giro in England. The main purpose of this institution is to offer the majority of the public the opportunity to make payments like house rent, telephone bills, taxes, subscription fees, etc. by way of girochecks at a very low cost and also to make transfers.

The Giroservice is an institution owned by the Government of the Island of Curacao and deposits are held by the private sector, Central Government, and several banks. Deposit holders cannot be debtors at the Giroservice. This means they are not allowed to owe the Giro-service money. This institution does not make loans to its clients and also does not pay interest on deposits; they also don't have

savings accounts.

All excess funds are deposited with the Island Tax Collector and in this manner the Island Government of Curacao obtains liquid funds to finance Island Government expenditures. Very little of this money is used for local development projects.

On before-mentioned excess funds, the Island Government pays 4% interest, but in the end the accrued interest returns to the Island Government. In other words, any amount deposited into the Giroservice means a deposit into the cash of the Island Tax Collector.

Even though the Giroservice in Curacao does not offer as many services as the one in Holland, future plans are being developed to expand the range of services.¹³

Formerly, all assets of the Giroservice were entirely composed of claims on the Island Government of Curacao, but in 1980 the Central Bank of the Netherlands Antilles compelled the Giro to build up its own liquid cash reserves in order to guarantee its own liquidity. Cash reserves rose from Naf. 1,5 million in 1980 to Naf. 6,1 million in 1983, as is shown in Table 2.10.

The other islands of the Netherlands Antilles don't have a Giro-service. In Curacao, it is counted among the money-creating institutions as the obtained funds (deposits) are extended as a credit to the Island Government of Curacao. Thus, the Giro creates liquidity for the benefit of the Island Government of Curacao.

Table 2.10. Girodienst summary account (Naf. in millions)^a

	1980	1981	1982	1983	1984
Assets:					
Claims on:					
Government Curacao	66.4	56.2	55.1	56.9	67.8
Cash reserves	1.5	4.5	5.7	6.1	6.7
Total	67.9	60.7	70.8	63.0	74.5
Liabilities:					
Deposits of:					
Central Government:					
Checking account	3	2	4	6	8
Special account ^b	36.7	32.6	31.5	31.5	31.5
Banks	4.7	3.8	1.3	2.1	5.5
Private sector	26.2	24.2	27.6	28.8	36.7

^aCentral Bank Quarterly Bulletin, Vol. 3, 1984.

^bComprises tax obligations of the Island Government of Curacao to the Central Government, deposited on a blocked account at the Giro-service.

Footnotes

1. It is interesting to know that the Curacaosche Bank, now the Bank van de Nederlandse Antillen or the Central Bank, was established in 1828 and in the beginning it was a government institution as well as a commercial bank. With the continuous increase in the number of private banks in the Netherlands Antilles, the Curacaosche Bank ceased to operate as a commercial bank and in 1962 the Curacaosche Bank was changed into the Bank van de Nederlandse Antillen.
2. The Spaar en Beleenbank van Curacao, established in 1850 and de Curacaosche Hypotheekbank, established in 1876, are now wholly owned by the Maduro and Curiel's Bank.
3. Bankwezen Nederlandse Antillen, belangrijke structuur veranderingen (I) Drs. H. Evers, Werkgroep Integrale Ontwikkeling.
4. See footnote 2.
5. This bank merged with Barclays Bank PLC.
6. The Caribbean Mercantile bank is now a subsidiary of Maduro and Curiel's Bank N.V.
7. In 1983, Bank of America ceased operation in Curacao and the First National Bank of Boston took over the bank.
8. In as far as these are not consolidated with primary banks. If it is owned by or has been acquired by a monetary creating institution then from a monetary point of view it is no longer considered a secondary institution but consolidated with the parent company.
9. Offshore financial activities in the Netherlands Antilles consist of financial transactions -- borrowing, lending and investing -- between two or more entities located outside the jurisdiction of the offshore center. Government policy in the Netherlands Antilles has been designed to ensure that offshore activities remain strictly separated from local financial transactions.
10. Pierson Heldring and Pierson N.V., before an offshore bank, received permission from the Central Bank to provide services to residents in the Netherlands Antilles. They will not deal in savings deposits (retail banking) but in capital management, trade financing, deposit and foreign exchange trade and in the trade of securities. Thus, their main local business will be wholesale banking.

11. The phenomenon in which the creation of modern financial institutions, their financial assets and liabilities and related financial services is in response to the demand for these services by investors and savers in the real economy.
12. The preferential low tax treatment, as mentioned before, is bound to the condition that the company will not engage in any trade or business within the Netherlands Antilles -- the income of the company must be fully derived from sources outside the Antilles. However, local banks can do local business and conduct international banking activities but under the same conditions as offshore banks.
13. The Giroservice plans to issue guaranteed girochecks. With this check, merchants can be sure that they will receive their money, even if the account of the customer lacks the required amount of funds. This, then, will render the prohibition of being a debtor at the Giroservice obsolete. However, these checks will be issued to customers whose monthly stream of income is certain, for instance, government employees whose salary is paid out or deposited at the Giroservice at the end of the month.

3. NONMONETARY BANKING INSTITUTIONS

3.1. Introduction

Although commercial banks are the dominant type of financial intermediaries in the Netherlands Antilles, as noted before they are not the only type.

Next to these institutions, we have the savings and mortgage banks which are labeled as nonmonetary banking or secondary institutions. These banks borrow by accepting savings deposits and then lend by investing in mortgages. In principle, though not in detail, it is doing just what a commercial bank is doing: namely, intermediating between two different groups of people. The main characteristic of secondary institutions is that they do not have demand deposits, they do not create money in the sense of a medium of exchange but merely transfer savings. But on the other hand, they create highly liquid financial assets by way of acquiring financial instruments.

In the Netherlands Antilles, we don't have a well-developed money market or capital market. Hence, the most important investment activities of these institutions is the supply of mortgage loans on dwellings and investment in foreign assets (near money). Mortgage loans comprised 76% out of total assets in 1983, while foreign assets have been declining. On the liability side, we notice that savings and time deposits are far less than the savings and time deposits of commercial banks. Most of the loans to the private sector are for consumption purposes.

The problem with mortgage loans on dwellings is that they do not create long-term employment that will continue to generate income. Even though the share of foreign investment decreased, we still notice the risk averse nature of these secondary institutions as they invest in areas with a very low risk. The reason most heard is that there are no viable investment projects in the Netherlands Antilles. Other types of nonmonetary financial institutions are the so-called institutional investors like pension funds and life insurance companies that will be described in 3.3.1 and 3.3.2, respectively, while paragraph 3.2 will give a list of nonmonetary banking institutions.

3.2. Institutions

Algemene Hypotheekbank N.V.

Antilliaanse Hypotheekbank N.V.

Banco Nacional de Hipotecas N.V.

Bouwcredietbank van de Nederlandse Antillen

Caribbean Mortgage Bank N.V.

Centrale Hypotheekbank N.V.

Caribbean Credit Corporation N.V.

Centraco Financieringsmaatschappij N.V.

Antilliaanse Financieringsmaatschappij "Anfimij" N.V.

H.J. Ruiz N.V.

N.V. De Curacaosche Hypotheekbank

N.V. De Spaar- en Beleenbank van Curacao

N.V. Wederopbouw Willemstad

Stichting Bouwfonds N.V. Electriciteit Maatschappij "Aruba"

Postspaarbank

Island Finance (St. Maarten) N.V.

Stichting Volkswoningbouw

Volkskrediet Bank van de Nederlandse Antillen

Fundashon Fiansa Popular

Island Finance N.V.

Island Finance (Aruba) N.V.

Corporashon pa Desarollo di Corsow "CODECO" N.V.

Ontwikkelingsbank van de Nederlandse Antillen N.V. (OBNA)

Banco Arubano di Desarollo N.V.

3.3. Institutional Investors

Pension funds and life insurance companies operating in the Netherlands Antilles are considered institutional investors. People save in pension funds and buy life insurance policies to protect themselves against the risk of not having an income in their old age. Hence, we might say that the driving force that causes people to have an insurance policy and to pay a fixed amount of money to the pension fund each month is the precautionary motive.

Just like deposit banks, these institutions are mobilizers of financial surpluses and sources of long-term funds, because someone who enters a pension fund or buys a life insurance policy probably begins to receive payments at the age of 65.

These institutions, in fact, have a long-term contract with the savers that is fulfilled by a regular payment of a pretty stable amount and over a long period of time. The premium in the early years of a policy is excessive in relation to annual risk. As the insured grows older, the risk becomes greater until in later years the premium will become eventually smaller than annual risk. It is the essence of life insurance that large life funds will be accumulated to cover claims payable at a considerable period after the contract has been concluded.

The tremendous amounts of funds that these institutions receive and that they do invest in the American or European capital markets do create additional sources of funds available for investment, namely, the maturing bonds can be reinvested, and the dividends and interest received on existing bonds and stocks are another source of funds. Life insurance companies are potential sources of near money, because the liabilities of a life insurance company are the assets of the policy holder. This, in turn, enables the insured to borrow using his life insurance policy as collateral or he may also sell it.

In the Netherlands Antilles, there are eight life insurance companies, eighteen pension funds, and twenty-two thrift foundations. All these institutions are subject to regulation by the Central Bank under the National Ordinance of June 26, 1972.

3.3.1. Pension funds and thrift foundations

In the Netherlands Antilles, these institutions have been set up by the government or local enterprises to provide their personnel an

old age pension. Thrift foundations have been formed to assist their personnel with saving and sometimes provide loans or advances. Table 2.11 presents a consolidated balance sheet for above mentioned institutions.

A striking feature of this balance sheet is the high proportion of foreign assets. In 1979, foreign assets comprised 71% of total assets. The reason for this behavior, they allege, is:

- 1) the lack of viable investment projects,
- 2) the absence of a capital market,
- 3) investment in the American capital market allows for better risk diversification and, in turn, the funds of the savers are better protected in this way.

Thus, most of the funds leave the country to develop other countries, notwithstanding the fact that economic growth in the Antilles has been declining. On the asset side of the balance sheet, we can see that most of the loans are made to the conventional areas that have a low risk factor involved, like private sector (consumption purpose), mortgages, and financial institutions.

To stop the flow of domestic savings to foreign countries, the Central Bank issued a regulation whereby institutional investors must invest 40% of total assets domestically and 60% abroad. This again is a generous incentive of the Central Bank, but not too effective as the bank does not tell these institutions in what areas to invest, for example, development projects. Thus, what happens is that they follow the Central Bank's regulations, but they only invest where the

Table 2.11. Pension funds and thrift foundations^a (Naf. in millions)

	1979	1980	1981	1982
<u>Assets</u>				
Liquid assets	18.2	20.1	27.2	27.5
Loans to Central Government	4.4	7.8	9.5	9.7
Loans to Island Government	24.5	19.6	19.4	19.4
Loans to financial institutions	40.1	46.0	49.9	49.9
Loans to members	8.8	10.9	10.9	11.2
Mortgages	31.0	28.9	30.4	30.4
Other loans	8.3	17.3	29.4	29.3
Loans to private sector	48.1	57.1	70.1	70.9
Real estate and inventories	19.5	41.7	46.1	46.1
Other assets	38.1	105.7	108.5	108.3
Total domestic assets	192.9	298.0	331.3	331.7
Total foreign assets	460.8	499.2	528.6	529.0
Total assets	653.7	797.2	859.9	860.7
<u>Liabilities</u>				
Reserve and capital	619.9	747.5	808.6	809.3
Credit from banks	-	2	2	2
Total funds borrowed	-	2	2	2
Other liabilities	33.8	49.5	51.1	51.2
Foreign assets as a percentage of total assets	653.7 (70.5)	797.2 (62.6)	859.9 (61.5)	860.7 (65.3)

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.

risk is low (risk averse).

The pension fund of civil servants, called Algemene Pensioen Fonds Nederlandse Antillen (A.P.N.A.) is the largest pension fund in the Netherlands Antilles.

A strategy has to be developed whereby funds of the pension funds are channeled to domestic development projects that generate employment, income and international reserves. More than 60% of these funds now leave the country. What remains in the country is used to finance deficits of quasi-government institutions or are used for mortgages or other events involving low risk. However, the Netherlands Antilles have something peculiar. Compared to other islands in the Caribbean and even other countries in Latin America, it must be said that the Antilles have a very good social security system. Many of these social security regulations in the Antilles have been taken over from the Netherlands.

To finance these social security expenses, the government needs revenues that in turn come from taxes. Now, a decline in economic activity, as is the case right now, leads to a decline in national income and a decline in government revenues. And when government expenditures exceed government revenues, we have a deficit. Experience shows that when the Island Governments and Central Government have deficits, this leads to large arrears in pay off contributions to the pension funds of civil servants (A.P.N.A.), the largest pension fund in the Netherlands Antilles. In the private sector, a decline in economic growth leads to unemployment or closing of the company no matter whether the employees are in a pension fund or not. Hence, the constant flow of funds toward the pension fund is jeopardized due to economic conditions of the country. In the case of the Netherlands

Antilles, where the funds are invested abroad, it means that less can be invested abroad. The funds that they will receive are the interest or dividends accrued on the funds of matured investments. In other words, a decrease in economic growth in the long run will affect the pension fund. This can be prevented by using the long-term funds of these institutions in local development projects that will keep the economy growing, and in this case, the government can play an important role. The following list indicates all the pension funds and thrift foundations in the Netherlands Antilles as of January 1985.

Algemeen Pensioenfonds van de Nederlandse Antillen (A.P.N.A.)

Gouvernements Weklieden Pensioenfonds

Stichting Pensioenfonds voor A.L.M. Vliegers

Stichting Pensioenfonds voor Antilliaanse Energiebedrijven

Stichting Pensioenfonds Samenwerkende Havenbedrijven

Stichting Pensioenfonds van de A.B.N. N.V. Nederlandse Antillen

Stichting Pensioenfonds Havenwerkers Aruba

Stichting Pensioenfonds Madura & Curiel's Bank

Stichting Pensioenfonds Shell Curacao

Stichting Pensioenfonds voor Personeel v.d. N.V. Curacaosche
Dok Maatschappij

Stichting Pensioenfonds Consales Bedrijven

Stichting Pensioenfonds voor de Bouwnijverheid

Stichting Pensioenfonds Smeets-Trust

Stichting Pensioenfonds Horecaf

Stichting Directie Pensioenfonds Winair N.V.

Stichting Pensioenfonds VANDDIS Groep
 Stichting Pensioenfonds S.E.L. Maduro & Sons
 Stichting Directie Pensioenfonds "La Aurora"
 I.B.M. World Trade Corporation Netherlands Antilles Foundation
 Lago Annuity Foundation
 Lago Thrift Foundation
 Stichting Fundashon Nos Deseo
 Stichting Voorzieningsfonds N.V. Aruba Bank
 Stichting Voorzieningsfonds Van Dien & Co.
 Stichting Spaarfonds HMK/HMB
 Stichting Voorzieningsfonds E. Moreno Brandao & Sons N.V.
 Stichting Voorzieningsfonds Werknemers Antem, Elga, Anlo, KKO
 Stichting Voorzieningsfonds A.L.M. Personeel
 Stichting Spaarfonds San Francisco
 Stichting Voorzieningsfonds voor Personeel Botica Wilhelmina
 Voorzieningsfonds van de Curacao Trading Company (N.A.) N.V.
 Voorzieningsfonds van Spritzer & Fuhrmann N.V. en van
 Spritzer & Fuhrmann Aruba N.V.
 Fonds Ziektekosten Overheidsgepensioneerden
 Spaarfonds Garage Cordia
 Stichting Voorzieningsfonds van de N.V. Curacaosche Dok
 Maatschappij
 Voorzieningsfonds Morris E. Curiel & Sons N.V. e.a.
 Voorzieningsfonds "Caja de Ahorros Y Préstamos de los
 Trabajadores del Banco Industrial de Venezuela-Curacao"
 Stichting Vokad Spaarfonds

3.3.2. Life insurance companies

These companies provide financial protection against life's various misfortunes. According to the National Ordinance on the Supervision of Banking and Credit Institutions, life insurance companies have to register at the Central Bank. At the moment, there are eight life insurance companies that are registered at the Central Bank.

In contrast to the pension fund, these insurance companies invested a smaller part of their funds abroad and a much larger share domestically. However, the pattern of domestic investment is similar to the one of the pension funds and the reason is the same. These companies also have a much smaller capital than do the pension funds. Table 2.12 gives an illustration of the life insurance assets and liabilities. It becomes evident that this trend has to be changed. The government should determine certain priority areas that it considers important to develop and a strategy has to be developed to channel funds from the surplus sectors (households) to the deficit sectors. Observing our narrow economic base, we may conclude that much has to be done to broaden the base and build up a more solid structure. The funds to do so are present. However, the high risk aversion of the financial sectors and the lack of identified high priority areas by the government as well as regulations to channel these funds to investment projects are a severe obstacle to the development of the Antilles.

Table 2.12. Life insurance companies^a (Naf. millions)

	1980	1981	1982	1983 ^b
<u>Assets:</u>				
Liquid assets	2.5	2.7	7.1	12.0
Loans to Central Government	7.3	11.9	14.6	14.4
Loans to Island Government	5.9	6.3	4.2	5.6
Loans on policies	8.5	12.8	13.0	12.8
Mortgages	39.2	49.4	58.0	63.5
Other loans	5.6	3.7	3.7	4.1
Loans to financial institutions	1.7	1.7	4.7	1.0
Loans to private sector	53.3	65.9	74.7	80.4
Real estate inventories	6.9	11.6	14.9	13.7
Other assets	9.0	7.9	60.3	69.2
Total domestic assets	86.6	108.0	135.9	162.8
Foreign assets	50.6	62.4	60.3	69.2
Total assets	137.2	170.4	196.2	232.0
<u>Liabilities:</u>				
Reserves and capital	118.6	147.0	165.7	196.4
Credit from banks	-	-	-	-
Funds borrowed from financial institutions	5.6	6.6	6.4	7.2
Other funds borrowed	3.2	5.9	12.9	15.6
Total funds borrowed	9.3	12.5	19.3	22.8
Other liabilities	9.3	10.9	11.2	12.8
Total liabilities	137.2	170.4	196.2	232.0
Foreign assets as a percentage of total assets	(36.7)	(36.6)	(30.7)	(29.8)

^aCentral Bank Quarterly Bulletin, Vol. 4, 1984.^bProvisional figures.

As of January 1985, the following life insurance companies were registered at the Central Bank and operating in the Netherlands Antilles.

American Life Insurance Company Ltd.

British American Life Insurance Company Ltd.

Travelers Life Insurance Company Overseas Ltd.

Crown Life Insurance Company

ENNIA Levensverzekering N.V.

Nationale Nederlanden Levensverzekering Maatschappij N.V.

The National Life Assurance Company of Canada

United Security International Insurance and Reinsurance Ltd.

3.4. Credit Unions

Credit Unions are nonprofit, cooperative associations organized around some common membership, typically a common employer or religious group, whose members borrow from and to each other, often to buy durable consumer goods.

Thus, credit unions are mutual organizations owned by their members and the deposits are considered shares, while the interest payments on these deposits are considered dividends.

What distinguishes the credit union from other financial institutions is the common bond requirement for membership. The officers of the credit union are elected among the members and usually work on a voluntary basis without payment. Many times the sponsoring organization offers free office space. These two features lower the operating

costs of credit unions and as a result consumer loan rates are also lower than those of deposit banks.

The main purpose of credit unions is to promote saving among members and provide them with low-cost consumer credit.

In the Netherlands Antilles, credit unions are divided in two categories:

- 1) district credit unions or barrio credit unions,
- 2) industrial credit unions or professional credit unions.

3.4.1. District credit unions/barrio credit unions

These are community-oriented credit unions. In other words, the members live in the same vicinity. These credit unions also have a social tendency.

Until 1970, the district credit unions were dominant in number and impact, but after 1970, a new type of credit union emerged, namely, the professional credit unions which began to grow at the costs of barrio credit unions. The main factors that contributed to this development are:

- 1) the relatively high rate of delinquent loans in the barrio credit union,
- 2) the relatively low rate of security on pay back,
- 3) the growing needs for bigger loans,
- 4) better and easy saving and loan system guaranteed by the collective agreements in professional credit unions,
- 5) the relatively higher security, guaranteed by the working place that the loan will be paid in time (Beniamini, Haim, 1980).

In the barrio credit union, the common bond did not make borrowers reluctant to default on loans. These defaults probably have been the result of lack of expertise in how to manage a credit union financially. These developments led to a decrease in membership (and as a result a decrease in savings), all to the benefit of industrial or professional credit unions.

3.4.2. Industrial credit unions

These are occupation-based credit unions. They are mainly found with large and middle-large companies and institutions. In contrast to the barrio credit unions, in these unions, the officers are partially hired and partially volunteers, and the administration is done in a more sophisticated way. These unions often use computer services and managerial services and have accounts in commercial banks. The savings of industrial credit unions are higher than the savings of barrio credit unions.

Another advantage is that professional credit unions obtain low-cost information on the income and job security of borrowers. Also, loan repayments can be processed inexpensively through payroll deductions, which in turn reduces the risk of default. Moreover, payroll deduction plans are not only convenient for depositors but also assure the credit union of a constant inflow of funds, which is important as deposits are the only source of funds for credit unions. On the other side, a common bond based on employment restricts the asset growth of a credit union to the growth of its sponsoring firm. A

sudden plan closing or substantial lay offs can create severe liquidity problems for credit unions and may force them into liquidation (Pearce, 1984).

The rate of interest that both types of credit unions charge is 1% per month calculated on the monthly balance of the loan.

Many but not all of the credit unions joined the master organization Fekoskan (Federashon di Cooperativanan di Spaar i Credito Antiyanan Neerlandes). They are also associated with the Credit Union National Association (CUNA) and the Confederacion Latina America Credit Unions (COLAC), which forms part of the World Council of Credit Unions.

The master organization provides:

- 1) legal advice and administrative assistance to affiliated credit unions;
- 2) courses for members of the board of management, supervisory boards and credit committees;
- 3) represents the credit unions vis-a-vis the government and the Central Bank in the consultation of monetary policy;
- 4) acts as a clearing institution for the credit unions and assists the unions when they have liquidity problems.

Being a credit union, these unions automatically fall under the National Ordinance on Supervision of Banking and Credit institutions and as such must register with the Central Bank. Credit unions are not as powerful as those in the United States. The largest is one of the government officials: The Ambtenaren Credit Union (A.C.U.). However, credit unions are not of vital importance in the financial development of the Netherlands Antilles.

3.5. Ontwikkelingsbank van de Nederlandse Antilles

(Development Bank of the Netherlands Antilles)

A development bank is a financial institution whose lending policy is guided in part or in total by the perceived economic, social or political needs of a country or region rather than by commercial goals alone.

Many studies made by economists suggested for a long time the establishment of a development bank in the Netherlands Antilles to facilitate the financing of long-term investment projects, as commercial banks cannot finance these projects due to the short term nature of their sources.

On October 1, 1981, the development bank, called the Ontwikkelingsbank van de Nederlandse Antillen N.V., was officially inaugurated by the Minister of Finance of the Netherlands Antilles, and was opened to the public in February 1982.¹

The Board of Governors is composed of the public sector as well as the private sector.

The main objectives of this bank are:

- 1) balanced economic development² of the Netherlands Antilles,
- 2) the promotion of enterprises and establishment of projects that contribute to the economic development of the Netherlands Antilles,

Projects that qualify for financing are:

- 1) manufacturing industry, processing and assembly;

- 2) construction industry, transport and tourism industry;
- 3) agriculture, horticulture, cattle-breeding and fishing.

To realize these objectives, the bank provides technical and administrative assistance as well as financial advice. The bank participates in enterprises and projects. The authorized capital of the Ontwikkelings Bank van de Nederlandse Antillen was set at Naf. 15 million of which 60% is from the public sector and 40% from the private sector. The capital structure of the bank as of December 31, 1982 was as follows:

<u>Public sector</u>	<u>Subscribed</u>	<u>Paid up</u>
Central Government	Naf. 1,500,000	Naf. 1,500,000
Island Government of Curacao	Naf. 1,500,000	Naf. 1,500,000
Island Government of Bonaire	Naf. 750,000	Naf. 750,000
Island Government of Windward Islands	Naf. 750,000	Naf. 750,000
Total	Naf. 4,500,000	Naf. 4,500,000
<u>Private Sector</u>		
Maduro & Curiel's Bank N.V.	Naf. 600,000	Naf. 600,000
Algemene Bank Nederland N.V.	Naf. 250,000	Naf. 250,000
Barclays Bank of the Netherlands Antilles N.V.	Naf. 100,000	Naf. 100,000
Banco Industrial de Venezuela S.A.	Naf. 250,000	Naf. 250,000
Banco di Caribe N.V.	Naf. 25,000	Naf. 25,000

<u>Private sector</u>	<u>Subscribing</u>	<u>Paid up</u>
Curacao Banking Corp.	Naf. 50,000	Naf. 50,000
N.V.	Naf. 50,000	Naf. 50,000
Bank of Nova Scotia		
N.V.	Naf. 50,000	Naf. 50,000
Grand total	Naf. 5,825,000	Naf. 5,825,000

The Bank also received a soft loan of ECU. 840,000 (Naf. 2.5 million) from the European Investment Bank and a soft loan of ECU 750,000 (Naf. 1.3 million) from the European Economic Community. These loans are to be used to augment the Bank's capital contribution from the public sector and for agricultural projects, respectively.

The Nationale Investeringsbank N.V. (N.I.B.) and the Nederlandse Participatie Maatschappij voor de Nederlandse Antillen N.V. cooperate with the development bank in the form of co-financing of projects and of training facilities for the bank's staff.

To enhance its operating funds, the floating of a bond issue with a tax-free facility to bondholders is being discussed with the Minister of Finance. This issue would have to be guaranteed by the Central Government and could be floated at a rate well below the going market rate, creating in this manner funds which could be lent at a beneficial rate to development projects and still retain a profitable margin or spread for the bank.

The development bank finances projects up to a maximum of Naf. 500,000, and the interest rate varies between 9 and 12% for the industrial sector, tourism and transport. The interest rate for agricul-

ture is 7%. The interest rate does not fluctuate with market interest rates but is fixed over the whole period of the loan. Projects that exceed the amount of Naf. 500,000 are financed if they are economically and technically feasible, and the funds are obtained from other financial institutions. The policy of the bank is to diversify as much as possible instead of putting all eggs in one basket. The Development bank also offers a grace period of 2 years to, for instance, agricultural projects.

At the end of 1984, the bank received 286 requests that needed to be financed. From these 286 requests, 76 were approved, up to a total amount of Naf. 7,923,500. Ninety-three were canceled and the remainder were still in the process of evaluation. The seventy-six approved projects can be divided as shown in Table 2.13, although six were canceled on request of their promoters. Forty-five have already received financial means up to a total of Naf. 5,063,000.

Twenty-two percent of total loans went to the agricultural sector, which contributes 1.6% to national product, while 40% went to the industrial sector, which contributes 8% to national product.

From a macro viewpoint, the bank created 20 new jobs in the agricultural sector, 37 in the tourist sector and 15 in the industrial sector. The bank's investment contributed to the maintenance of 53 employment opportunities of which 23 were in the agricultural sector and 30 in the industrial sector.

Table 2.13. Approved projects in different sectors

	Number of projects industrial sector	Naf.	Number of projects in agricultural sector
Curacao	11	2,602,500	30
Bonaire	1	183,000	9
St. Maarten	1	415,000	1
St. Eustatius	-	-	4
Saba	1	20,000	5
Total	14	3,220,500	49

Naf.	Number of projects in tourism sector	Naf.	Number of projects in transport sector	Naf.
1,380,000	3	1,375,000	1	500,000
105,000	2	295,000	1	10,000
90,000	1	5,000	2	63,000
65,000	1	390,000	-	-
121,000	2	404,000	-	-
1,761,000	9	2,369,000	4	573,000

3.5.1. Possible role of the development bank

The Ontwikkelings Bank van de Nederlandse Antillen can become an important link between the suppliers of funds (Funds of households at the financial institutions) and those who need funds (investors). The bank can also play an important role in diversifying the economic base of the Netherlands Antilles and in this way reduce the foreign dependence on basic goods. They can also foster entrepreneurship on the island. Lack of it is an enormous constraint on development.

The agricultural sector, horticulture, cattle-breeding and manufacturing are sectors that have been neglected in the past. Most of the funds went to the trade sector to finance imports and exports, or simply left the country by means of buying foreign assets. Even though the trade sector created much employment, it is highly susceptible to foreign shocks.

The reason for neglecting these sectors are:

- 1) banks are risk averse and conservative and follow the demand-leading approach, and their funds are short term;
- 2) lack of low-risk, viable investment projects induces institutional investors to invest abroad where risk can be diversified. These investors, however, have long-term funds.

However, the development bank can become an intermediary that has the power to reduce the risk aversion and conservatism of money-creating institutions and provide viable projects, which lower the outflow of money and create more employment opportunities.

To achieve this objective, the bank should follow the supply-leading approach. The funds should be channeled toward those sectors that will cause growth. The bank should aggressively go out and search for projects and not wait till someone shows up, as has been the case with many institutions, or study the local market and come up with projects that are feasible. A marketing plan should be developed and the islands should be promoted abroad to attract prospective investors, especially those that are in high tech industries.

The development bank has the expertise to analyze projects, and especially in Curacao the infrastructure is already present.

Supply-led growth opens new horizons to those who have plans and entrepreneurial skills but due to lack of financial means (especially long term) could not carry out their projects. Supply-leading finance presents an opportunity to induce real growth by financial means. It also plays a significant role at the beginning of the growth process (Meier, 1976).

Economic growth is what the Netherlands Antilles really need as growth has almost come to a complete standstill. The financial means are also present both short term and long term. However, even though the Development Banks, its approach should be more aggressive than that of the other conservative financial institutions in order to stimulate economic activity, it should not lose sight of the risk factor in every project to prevent bankruptcy.

Footnotes

1. The Island Territory of Aruba withdrew from participation in the Ontwikkelings Bank van de Nederlandse Antillen and has its own development bank.
2. Economic development in this context implies:
 - the development of manufacturing, processing and assembly industries;
 - the development of building, construction industries transport enterprises and tourism;
 - the development of projects in the field of agriculture, animal husbandry, horticulture, and fisheries.

4. FINANCIAL MARKETS

4.1. Introduction

Business firms, as well as individuals and government units, often need to raise capital. Capital formation is one of the main factors responsible for economic growth. For instance, if the waterplant forecasts an increase in the demand for water in its service area and decides to expand the water plant, they will have to raise capital to finance the investment. In society, there are entities that have incomes which are greater than their expenditures and these excess funds can be used to invest. There are also entities wanting to borrow money, in other words, demanding funds. Now, the suppliers and demanders are brought together in the financial markets.

There are many types of markets, however, we shall only discuss two markets in this thesis, namely, the money market and the capital market.

4.1.1. The money market

The money market consists of many interlocking markets in which borrowers raise funds to finance their operations. The money market is a market for short-term funds. Banks convert short-term assets to cash at an acceptable cost. For the Central Bank, the money market serves the function of conducting open market operations.

In the Netherlands Antilles, the money market is situated at the local deposit banks. However, this market is not as sophisticated as

those in the developed countries. The main instrument of the local money market is the use of time deposits and savings deposits. These deposit facilities are offered to individuals, firms, and corporations.

Local deposit banks also engage in short-term lending for commerce and construction, and issue letters of credit to merchants. This letter of credit functions more or less like the bankers acceptance in the United States, but it is not negotiable. With this letter of credit, the exporter abroad can be sure that the bank will pay for the products ordered by the importer in the Netherlands Antilles.

Another short-term instrument is the government treasury bill. These treasury bills can be bought by everybody and as much as you want. However, these short-term papers are mainly bought by banks. The maturity period of treasury bills varies between three and twelve months, and the interest rate on a three-month treasury bill is 7.25% and on a 12-month treasury bill 8.25%. For the past two years, these interest rates did not change. However, the interest rate on bonds and treasury paper tend to vary positively with the interest rate developments in the U.S. bonds and treasury paper. If the interest rate on the latter rises, then the interest on treasury paper in the Antilles also rises; this is done to prevent large outflows of funds into the American money and stock market.

When banks have excess liquidity, they can buy certificates of deposits at the Central Bank and receive 5% interest on these certificates.

Banks are the principal domestic traders in foreign exchange (mainly U.S. dollars). Individuals who would like to invest in the money market in the United States or have a time deposit (six months up to a year) in the United States or somewhere else where higher interest is received can do this via a local deposit bank (see Chapter 3 under foreign exchange controls).

Interbank deposits are being made, but no market has been developed. There is also no interbank loan market where deficit banks borrow from surplus banks as is the case in the United States. Banks in the Netherlands Antilles are pretty liquid. Short-term funds is not a problem in the Netherlands Antilles, but to get medium- to long-term funds is difficult due to the short-term nature of commercial banks, their resources, and the lack of capital market.

4.1.2. The capital market

Capital markets are markets for long-term debt and corporate stocks. Just as in the money market, we also find the surplus sector providing resources directly or indirectly through the financial intermediaries and the deficit sector absorbing these funds. But here we talk about long-term funds. The capital market thus works as a machine to channel the flow of financial savings into investment.

Capital markets arise partly because of the government requirement to borrow locally, and partly as a result of an expanding private sector that requires local funds for both expansion and new developments. The size, effectiveness and operation of such a market

depends, among other things, on the supply of capital (national saving), the extent to which the economy is monetized, the number of potential investors, and the degree of sophistication of the investing public (Arowolo, 1971).

In the Netherlands Antilles, there is no capital market or stock exchange market even though there is a well-developed financial system. The suppliers of funds in the Netherlands Antilles are:

- 1) households, consisting of individuals, small business enterprises,
- 2) corporations
- 3) government.

These same sectors also demand funds, however, for different purposes.

4.1.3. Households and corporations

Individuals supply funds through deposit banks and via institutional investors. The funds at deposit institutions are in the form of passbook savings, or savings accounts, while small businesses often have time deposits. The savings at the institutional investors comprise premiums usually deducted from individuals' salaries. The funds at these institutions, like pension funds and life insurance companies, have a long-term nature. The annual premiums that institutional investors receive each year is between Naf. 30 million and Naf. 40 million. Total savings at commercial banks in 1984 amounted to Naf. 817 million spread over 224,800 accounts. Pension funds invest 40% of their total assets domestically. Corporations deposit some of their surplus funds on time deposits (more or less Naf. 10 million each year). These time

deposits vary between one and three years.

4.1.4. Government

The Central Government issues bonds. In 1984, the Central Government issued Naf. 124 million in bonds, Naf. 11 million more than the preceding year. The Island Government of Aruba, due to the Lago Oil refinery taxes, had some surpluses in 1981 up to 1983. The offshore sector also allowed the Island Government of Curacao to have a surplus in 1982, due to the high profit tax received from this sector. Between 1979 and 1982, an amount between Naf. 150 million and Naf. 200 million was available in long-term funds completely generated from domestic resources and, moreover, these amounts remained in the country (Haan, 1984).

Another supplier of funds not mentioned before is the development aid received from The Netherlands, European Economic Community and the United Nations. Yearly, about Naf. 100 million is received in external aid.

4.1.5. Demand for long-term funds and factors inhibiting the development of a capital market

In the household sector, individuals mainly demand long-term funds for the construction of residential dwellings. Even though there is a well-developed financial system, getting a mortgage is not easy as the requirements of the commercial banks to extend a mortgage are severe. This is the result of the conservativeness and risk averse nature of financial institutions in the Netherlands Antilles. Another reason for

commercial banks to behave like this is that their largest source of funds, savings, has a short-term nature. The velocity of savings is very high. Hence, banks have a lack of long-term funds. For individuals, it is not easy to get an inexpensive mortgage. The annual interest rate on mortgages is 12.4%. Furthermore, the reserve requirements of the Central Bank also restrict banks to make medium-term to long-term loans.

Small business enterprises often are sole proprietorships. A proprietorship is easy and inexpensively formed, but on the other hand, it is very difficult to receive large sums of capital. Another problem with these small businesses is that their bookkeeping is inefficient. Many times, they cannot even present financial statements and sometimes they don't have bookkeeping at all. This restricts small businesses in obtaining capital to invest and expand their business or in getting into new ventures.

Corporations don't attract capital by issuing stocks or bonds domestically, but finance their investments from retained earnings, or obtain their funds from the mother company abroad, or from resale of their foreign assets in foreign secondary markets.

Most of the profits of these companies, received from their investment, is again invested abroad and not reinvested in the country. The complaint is as usual: abroad they receive higher interest and have more opportunities in diversifying their portfolio. These corporations have more confidence in the foreign stock markets. Only a small portion of

their profits is maintained on time deposits at commercial banks. Pension funds and life insurance companies, for the same reason as mentioned above, also invest part of their savings in the North American stock exchange market in order to protect their savers.

The quasi-government institutions like the electricity company (KODELA) and the telephone company (SETEL) also don't issue stocks or bonds to finance their investments. The Central Government issues bonds. The obtained funds are to be used for investment projects, which in turn will generate income and employment while the profits derived from this investment can pay back the annual interest and the face value of the bond at the time of maturity. However, these funds are used to finance deficits and current expenses of the government like wages and salaries and part of it also goes to unproductive investments. This behavior frustrates the role that the government could play in developing a small local capital market. Due to the high deficits in 1983 and 1984, the Central Government had to place bonds in order to finance these deficits, reducing the liquidity of financial institutions.

The decline in economic activity in the tourist sector, oil sector, and transportation sector caused a decline in government revenues. Uncertainty about the future of the Shell oil refinery, the offshore business and the political structure of the Netherlands Antilles also made the financial intermediaries reluctant to buy more government bonds as they suspect that the government, *ceteris paribus*,

might not be able to pay back the borrowed amounts of capital. Potential investors have taken an attitude of waiting, hence, investment slowed down.

The small size of the market, the lack of information on business enterprises and their financial situation are all factors that do not contribute to the establishment of such a market. As a result, there is a lack of confidence in the local market and funds flow out of the country to foreign markets.

The government will have to change its current policy in order to restore investors' confidence and the Ontwikkelings Bank van de Nederlandse Antillen (development bank) can become the center for long-term funds. These funds, for a great part, are now leaving the country. If they are put under control of the development bank they can be channeled into productive investment projects, and in this manner, fulfill the same role as that of a capital market.

5. THE CENTRAL BANK OF THE NETHERLANDS ANTILLES

5.1. History

The Central Bank of the Netherlands Antilles was founded in 1828 with a capital of four hundred thousand guilders. This bank provided the Colony with bank notes and also extended credit to the business sector. The bank functioned as a government bank.

In 1907, the statute of the bank was changed and the name of the Central Bank became the Curacaosche Bank. Its objective was the promotion of the economic development of the Colony of Curacao and its area of operation was limited to the Colony of Curacao. As the number of private banks were increasing, and hence their activities, the Curacaosche Bank had to relinquish a considerable part of its former functions such as its direct involvement in the financing of agricultural and commercial activities, and almost all of its bill broking after a short period of intense activity.

At the same time, however, the Curacaosche Bank was developing into a bankers' bank, providing the private banks with the resources they required to perform their functions. In order to discharge this new responsibility satisfactorily, the Curacaosche Bank had to devote more attention to the other half of its original mandate: the care of money circulation. Thus, the Curacaosche Bank's main activity was the care of money circulation and the granting of credits. The bank notes were covered by gold and silver coins kept in the vaults of the Curacaosche Bank.

In 1961, the charter of the bank was once again changed and the name of the Central Bank was changed from the Curacaosche Bank into the Bank van de Nederlandse Antillen and since then it has not been changed. The activities of the bank are restricted to the Netherlands Antilles and it has a branch office on the Island of Aruba and agencies on the Island of Bonaire and the Windward Islands. The statute of 1961 stipulates the rights and obligations of the Central Bank or Bank van de Nederlandse Antillen.

In 1972, the National Ordinance concerning the regulation of the supervision of banking and credit came into force. The functions which the new law vested in the Bank van de Nederlandse Antillen fell into two main groups. Firstly, the Central Bank was empowered to decide whether or not to admit new financial institutions to the Netherlands Antilles, a power which had hitherto lain with the national parliament under the terms of the State Regulations. In addition, the Central Bank obtained the power to exercise supervision over the institutions admitted -- in particular, with regard to their solvency and liquidity. In the subsequent sections, the position of the Central Bank or Bank van de Nederlandse Antillen will become more evident.

5.2. The Formal Structure of the Bank van de Nederlandse Antillen

The Central Bank is administered by a management consisting of a managing director, secretary, deputy secretary and board of directors.

The managing director, secretary and deputy secretary are appointed by the Governor from a list of three persons nominated by the board of directors. The managing director represents the bank and is appointed for an indefinite time and so are the secretary and deputy secretary.

5.2.1. The board of directors

The board of directors consists of five members. The chairman of the board is called governor director and is also appointed by the Governor of the Netherlands Antilles. The remaining members of the board are appointed, each position to be filled by the Governor, from three persons nominated for each position by the board of directors, after consulting the management. They are appointed for a period of four years and can be reappointed immediately. They can also be suspended, or prematurely dismissed by the Governor, by a National Decree including due grounds.

The management must provide the governor director with all information and on his request submit books and documents which are necessary for the correct discharge of his duties. He also has the right to be present when the cash funds of the Bank are checked and verified. The board of directors are in charge of the supervision over the management of the bank, and the Central Bank's budget needs their approval before it is submitted to the Minister. The other employees of the Central Bank are appointed and dismissed by the Government of the Netherlands Antilles (Central Government - Minister

of Finance). The Central Bank is a relatively independent government agency.

5.2.2. Independence of the Bank van de Nederlandse Antillen

The Central Bank is, in fact, that agency of the government responsible for the conduct of monetary policy and in the Netherlands Antilles its main function is the maintenance of the internal and external stability of the value of the country's monetary unit. In other words, the Bank van de Nederlandse Antillen has to maintain the convertibility of the Netherlands Antilles guilder (Naf.) and has to prevent inflation.

The Central Bank is a relatively independent agency because it is not completely outside the government. The Central Bank's decisions about monetary policy can be made independently of the Central Government policy. However, the Central Bank, in conducting monetary policy, tends to support the Central Government policy.

The Central Bank can be considered independent in the sense that the managing director, secretary, deputy secretary and board of directors are not appointed by the Central Government but by the governor of the Netherlands Antilles. The managing director, secretary, deputy secretary and governor director are appointed for a period that is unlimited and the other members of the board of directors are nominated and appointed for a period of four years and can be reappointed immediately.

Once the managing director is appointed, then he need not fear

Government since he is nominated for an unlimited period and is appointed by the governor of the Netherlands Antilles and not by the minister of finance or president of the Netherlands Antilles. The management is free to criticize government policy when their policy will lead to balance-of-payment deficits and, as a result, a decrease in international reserves, thereby jeopardizing the external stability of the Netherlands Antilles guilder. Secondly, the Central Bank makes profits. Most of the profits come from interest received on foreign assets. These profits are used to increase the bank's capital, reserve funds, and special reserve funds. Part of the Central Bank's profit is transferred to the Central Government.

Notwithstanding the foregoing arguments, the government can still exert its influence on the management of the Central Bank because the Central Bank's employees are appointed, dismissed and promoted by the Central Government. None of the before-mentioned actions can be executed by the managing director. Moreover, the Central Bank's budget needs the approval of the minister of finance (Central Government). Hence, the Bank van de Nederlandse Antillen can be considered relatively independent.

There are many arguments with respect to public ownership of Central Banks. Those favoring public ownership argue the following:

- 1) In a democracy, the responsibility for economic management is solely that of the elected government. The conduct of monetary policy is enhanced if the Central Bank is directly within the Government sector;

- 2) Hence, an independent Central Bank may thwart the policy of a government which enjoys considerable electoral support;
- 3) The profits of Central Banking should accrue to the Central Government.

Others favoring independence argue:

- 1) Central Banks enjoy a special relationship with commercial banks and other financial institutions and this relationship can be consolidated and enhanced by separation of the Central Bank and government;
- 2) An independent Central Bank may offer frank advice to the government. It may be able to carry out unpopular but necessary policies, which the government may refuse to do in order to avoid electoral displeasure (Stanford, 1972).

In the Netherlands Antilles, the staff members probably favor the statements of those who favor independence, since they are trying to make the bank completely independent of government.

5.3. Internal Organization of the Bank van de Nederlandse Antillen

The internal structure of the bank is composed of the following departments:

- 1) Research department
- 2) Accounting department
- 3) Cashier's department

From these three departments only, the research department will be highlighted, as this department's activities are more related to the topic of this thesis.

The research department collects and analyzes data on the economy in the Netherlands Antilles. The data include information on the financial sector, money supply, and balance of payment. The research department also observes the movements in international reserves, issues the Quarterly Bulletin and annual reports which contain statistical data and information about the current development in the economy, monetary developments, and public finance information. They also do some economic forecasting.

The research division consists of four sections:

- 1) Macro-economic section,
- 2) Exchange control division,
- 3) Statistical division,
- 4) Bank supervision and credit regulation division.

5.3.1. Macro-economic section

This section observes the growth rate of the money supply, its effect on the balance of payments and international reserves as well as the behavior of government budget policy and its effect on the economy. They also study the developments in the real sector of the economy.

Key figures are published in their monthly paper and economic developments in the foreign exchange generating sectors, and the policies taken by the Central Bank are published in the Quarterly Bulletin and Annual Report. In short, this section analyzes the macro-economic developments in the Netherlands Antilles from a monetary viewpoint.

5.3.2. Exchange control division

This division is charged with the implementation of foreign exchange controls and directives and sees that residents and nonresidents adhere to the foreign exchange policies.

5.3.3. Statistical division

The statistical division gathers data from the different sectors and financial institutions and transforms these data into useful data for the Central Bank and other interested sectors of the economy.

5.3.4. Bank supervision and credit regulation division

This division is charged with the supervision of credit institutions and associations. This department receives monthly statements from the financial institutions, and sees that adherence to the liquidity and solvency regulations as well as credit regulations are fulfilled.

5.4. Functions of the Bank van de Nederlandse

Antillen

The National Ordinance of September 25, 1961 gives the Central Bank the following important functions:

- 1) Circulation bank of the Netherlands Antilles,
- 2) Stabilization of the value of the country's monetary unit,
- 3) Foreign exchange bank for the country,
- 4) Supervision of banks and credit institutions and associations.

5.4.1. Circulation bank of the Netherlands Antilles

By the National Ordinance of 1961, the Central Bank obtained the exclusive right to issue bank notes in the Netherlands Antilles. The banknotes have the quality of legal media of payment until they are withdrawn from circulation. The form and denominations of banknotes to be issued are determined by the management and are announced publicly. Coins are issued by the government but via the Central Bank.

5.4.2. Stabilization of the value of the country's monetary unit

Since the second World War, the Netherlands Antilles guilder has been pegged to the U.S. dollar. In 1971, the Antillen guilder (Naf.) devaluated with respect to the U.S. dollar but since then it has remained stable at Naf. 1.78 per U.S. dollar.

The task of the Central Bank to maintain the stability of the value of the monetary unit is not an easy one.

The value of a monetary unit consists of an:

- 1) internal value
- 2) external value

The internal value of the money refers to the purchasing power of the Antillean guilder within the country while the external value refers to the fixed exchange rate between the Antillean guilder and the U.S. dollar. In other words, the Central Bank tries to prevent inflation and at the same time must try to maintain the convertibility of the Netherlands Antilles guilder, two things that in the Netherlands Antilles are incompatible.

To maintain the internal value of the monetary unit, inflation must be controlled or avoided.

The Netherlands Antilles is a very small and very open economy. Domestic production is insignificant and consequently imports very high, and as the exchange rate is fixed to the U.S. dollar it cannot adjust. Hence, the price level becomes given. Hence, an inflation in the country of our major trading partner (the United States) means an increase in our price level (imported inflation). As a result of our small domestic production and high imports, an increase in the money supply causes a slight increase in the domestic price level and thereafter a vast decrease in international reserves, which if not controlled jeopardizes the external value of the monetary unit. It seems that the Central Bank opted for the control of the external value of the monetary unit. In order to control inflation, or, more accurately, to lower the effects of an inflation, the government has a wage indexation scheme. When prices go up wages are automatically adjusted.

5.4.3. Foreign exchange bank for the country

The amount of international reserves is the vein of our economy. As a small open country, with a very narrow production base and where everything has to be imported, the amount of international reserves plays an important role. We may have an excess of Netherlands Antilles guilders, but without sufficient foreign reserves the Antilles would not be able to finance imports. The Central Bank therefore carefully

monitors the level of international reserves as well as the payment transactions with foreign countries. The Central Bank's foreign policy will be explained under the paragraph of Foreign Exchange Regulations.

5.5. Supervision of Banks and Credit Regulation

The Bank van de Nederlandse Antillen, the Central Bank, is vested with authority to supervise and regulate banks and credit institutions, by way of the National Ordinance of June 26, 1972, no. 138. This ordinance establishes that all credit institutions and credit associations will be subject to Central Bank supervision.

Credit institutions are defined as enterprises or institutions (with the exception of credit associations) which substantially make it their business to accept monies on deposit and/or grant credit facilities, for example, the primary and secondary banks and institutional investors.

Credit associations are defined as institutions whose purpose is to assist their members in saving and/or the granting of credit and advances to such members, for example, credit unions.

The above-mentioned definitions contain the following important components, namely, "substantially," "making their business," "to accept moneys" and "granting credit" that need some explanation.

"Substantially" refers to the total value of the financial transactions. For local credit institutions, their financial transactions are

considered substantial when the total value of liabilities or loans exceed an amount of Naf. 50,000.

"Making their business" refers to the scope and volume of activities involving either attracting money or granting credit. These activities must be exercised independently or autonomously. Activities conducted once or incidently do not fit the statement.

"To accept moneys" is related to the deposit money and money on current accounts as well as the loans obtained by issuing of bonds, notes or certificates. Liabilities due to suppliers or buyers credit do not classify for this purpose, nor do bank loans or overdraft facilities to finance the assets of a company.

Granting credit refers to making available moneys from one's own account to other entities with the obligation of repayment. Claims due to deliveries of merchandise or services rendered are not considered credits for this purpose, nor are investments in general negotiable securities (Beers, 1980).

Local credit institutions, offshore credit institutions, and credit associations have an obligation to register with the Central Bank so that the latter can have a global picture of the number of banks and credit institutions operations in the Netherlands Antilles.

Banks and all credit institutions and associations can start business after they received a declaration of no objection from the Central Bank.

Before admitting a bank, the Central Bank observes a number of

aspects. Some of them are:

- 1) The local market conditions, observing things like
 - a) convenience and needs of the public,
 - b) competition
 - c) operating efficiency
- 2) Corporate capital. For a bank, the minimum amount of capital amounts to Naf. 1,000,000. In general, it depends on the type of financial business conducted and the degree of responsibility that the shareholders accept.
- 3) The name and address, and curriculum vitae of each supervisory or managing director.
- 4) The reason for establishing a branch in the Netherlands Antilles, descriptions of their activities, and their experience in banking and administration.
- 5) The composition of the shareholders of the bank. A very powerful shareholder can drive the bank into a situation where it employs its resources in a manner which might jeopardize its liquidity and solvency.
- 6) With respect to a subsidiary in the Netherlands Antilles of a foreign financial institution, the Bank van de Nederlandse Antillen might notify the Central Bank in the home country to obtain information about the position and reputation of the bank.

In general, in admitting new banks, the Central Bank looks for reputable names. Between 1970 and 1984, no new banks were admitted as the Central Bank thought that there were sufficient banks to serve the needs of the local market. Only in the offshore sector were new banks still admitted.

To have some control on bank concentration and to prevent monopoly, established credit institutions are not allowed to make long-term investment in, or take over, other entities whether or not such entities are credit institutions, or merge with other entities, whether or not

such entities are credit institutions, or effect a financial reorganization or establish affiliates, branch offices or cash operations under any name whatever, nor reduce their subscribed or paid up capital, without prior consent of the Central Bank.

To ensure adherence to a sound monetary policy, the Central Bank of the Netherlands Antilles consults with financial institutions. In the case of no full agreement or a lack of cooperation in executing the agreed policy, the Central Bank is vested with authority to release general directives governing the business operation of the financial institutions. These directives are issued, amended, extended, or suspended by means of a National Decree.

5.5.1. Supervision

Other aspects the Central Bank closely observes are: solvency, liquidity, and the foreign-asset position of commercial banks. This is done to ensure soundness and prudent operation. Offshore banks are exempted from liquidity and solvency requirements and other supervisory regulations. Bank soundness refers to the risk exposure of banks. In general terms, the more sound a bank, the greater is its ability to withstand adverse economic conditions.

The solvency requirements in the Netherlands Antilles are pretty stringent in order to assure that each commercial bank has sufficient capital to protect depositors against unusual and unexpected losses of a bank and to put the branches of foreign banks on an equal footing with local banks.

5.5.2. Solvency

The solvency requirements in the Netherlands Antilles are as follows: the Central Bank assigned a percentage to each category of bank asset. In Table 3.1, we see that the solvency requirement for "discounted drafts and promissory notes" is 5% as it is less risky, but the percentage assigned to "participations engaging in credit-activities" under the heading credit, is 100%. Now, for each bank, the amount of assets placed in a certain category, say "discounted drafts and promissory notes," is multiplied by the relevant percentage -- in this case, 5%. After this is done for each category, the Central Bank takes the summation of all these categories, and the obtained sum is the required amount of networth that the commercial bank should have.

If a deposit institution extends a credit that exceeds 15% of its net worth, then the commercial bank needs an authorization from the Central Bank, and an additional solvency requirement equal to the solvency requirement will be applicable. The following example highlights the foregoing:

Suppose a customer of a bank takes a mortgage which exceeds 15% of the bank's net worth, say 25%. Then, in Table 3.1, we see that the percentage for "covered by mortgage," under the heading credits, is 5%. The amount between 0 and 15% of the net worth is charged the required 5% rate. The amount between 15 and 20% is charged an additional 5%, and so is the amount between 20 and 25%.

Table 3.1. Directives concerning solvency^a

Calculation of the minimum net worth Description	To be covered by net worth: in %
A. Discounted drafts and promissory notes	5
B. Credits:	
1. To the Central and Island Governments	0
2. Supported by a written guarantee of the Central and Island Governments	0
3. Covered by credit insurance	0
4. Covered by marketable securities	0
5. Covered by mortgage	5
6. To participants engaging in credit activities	100
7. Other credits	10
C. Regulations with regard to large credits which are subject to solvency requirements. If credits represents:	
1. 15-20% of net worth, an additional solvency requirement equal to the solvency requirement applicable to this item; this applies to the excess over 15%.	
2. More than 20% of net worth, an additional sol- vency requirement equalling twice the normal solvency requirement which applies to the excess over 20%.	
D. Amounts receivable and amounts prepaid	10
E. Securities	10
F. Participations:	
1. In credit institutions	100
2. In other institutions	20
G. Real estate and movables	30
H. Liabilities in connection with guarantees issued, continuing guarantees and letters of credit	2.5
I. Open foreign exchange positions	2.5

^a Central Bank Annual Report, 1969-1974.

With these measures, by varying the percentage, the Central Bank endeavors to minimize the risk of banks becoming insolvent. The higher the risk, the higher the percentage and vice versa. The solvency position is monitored on a monthly basis. Banks must adhere to the minimum capital requirements depending on the composition, type and size of their assets.

5.5.3. Liquidity

Next to solvency, the Central Bank carefully observes the liquidity of banks. Liquidity is a measure of the ease with which commercial banks can meet the demand for withdrawals by their depositors. This requires that banks maintain an adequate amount of cash on hand or possess the ability to readily acquire such cash. Economists, in general, believe that requiring banks to maintain a stated level of reserves would be a good way of ensuring adequate bank liquidity. Critics, on the contrary, argue that requiring banks to maintain a given level of reserves to a large extent deprives those reserves of their liquidity, because reserves that banks are required to maintain are no longer available to be paid out to the bank's customers. But in a small country such as the Netherlands Antilles, with no deposit insurance company, reserve requirements are a good way of protecting the deposits of the public.

The system used by the Bank van de Nederlandse Antillen, the Central Bank, is a different reserve requirement system. This means the liquidity requirement has been differentiated by types of deposits

and the accounting period seems to vary between one and twenty-four months. Differential liquidity requirements when based on deposits affect bank liquidity. The higher the turnover of the deposits, the shorter the accounting period, consequently the higher the liquidity percentage required.

Liquidities are described as

- 1) cash,
- 2) deposits with the Bank van de Nederlandse Antillen,
- 3) deposits with banks payable within three months,
- 4) deposits with the Giro service Curacao,
- 5) treasury bills,
- 6) discounted drafts and promissory notes,
- 7) marketable securities for 70% of the market value.

When an individual item which is subject to liquidity requirements exceeds 1% of the total liabilities, the liquidity requirements will be doubled in order to prevent the risk that a bank cannot meet a withdrawal on demand. However, the total liquidity ratio per item can, of course, not exceed 100%.

5.5.4. Time deposits and borrowed funds

Time deposits are defined as only corporate time deposits. Personal and other time deposits are treated by the Central Bank as "savings for the purpose of liquidity requirements." The liquidity requirements depend on the time remaining until maturity, as shown below.

	Percentage requirement
Due to banks payable on demand (debt from one bank to another)	100
Due to banks payable in less than one month	100
Borrowed funds maturing in less than one month	100
Suspense items positive	100
Bank's time deposits maturing in 1-24 months	10
Borrowed funds maturing in 1-24 months	10
Accounts of nonbanks payable on demand	20
Blocked accounts	20
Time deposits maturing in less than one month	20
Time deposits maturing in 1-24 months	10
Unused overdraft facilities	10
Guarantees, letters of credit	10

Thus, the original maturity of, for instance, a bank's time deposit and borrowed funds does not matter. What matters is the time left until maturity. Thus, if the original maturity of, say a time deposit is six months, but it matures within two weeks, then it goes into the category of "less than one month. When it is difficult to determine the time left until maturity, then the required percentage, which must be held as liquid assets, amounts to 10%, independently of the time left until maturity.

Savings are defined as both savings and time deposits of natural persons, societies and foundations. The criterion used to determine

the proportion of savings deposits to be retained as liquid assets is the velocity of circulation of these deposits. For example: for savings without withdrawal limitations (passbook savings), the requirement is one and one-half times the highest total amount of withdrawal of any of the preceding twelve months; for savings with withdrawal limitations (time deposits), the requirement is one times the highest total amount of withdrawal of any of the preceding twelve months.

Reserve requirements based on bank deposits and similar liabilities is the most common reserve requirement. This general type of reserve requirement affords banks the greatest liquidity as a result of the automatic adjustments in the level of reserves required in response to changes in the level of deposits. For the purpose of money-supply control, basing required reserves on deposits and similar bank liabilities is administratively the simplest and most direct approach, as the control instrument, reserve requirement, is directly linked to the object of control itself -- namely, deposits (Coats, 1983).

5.5.5. Foreign assets

The Central Bank also controls the foreign asset position of banks. Deposit banks in the Netherlands Antilles are not allowed to have a negative net foreign asset position, in order to prevent increases in foreign debts.

The computational methods used by the Central Bank, in computing the foreign asset holdings of banks, are complicated. Thus, the description will be general rather than in detail.

In general, the Central Bank knows the total amount of official reserves (gold and foreign exchange). However, the Central Bank wants to ensure that there are sufficient foreign exchange reserves available to cover imports during some months, say two months. Therefore, the Central Bank calculates the average imports during a period of twelve months. These data are received from the commercial banks. Once the bank knows the average imports and knows how much foreign exchange is needed to cover, say two months of import payments, the Central Bank then allocates the remaining reserves to the commercial banks, based on each bank's working capital and the amount of deposits it holds. Any amount in excess of the resulting maximum foreign asset position must be surrendered to the Central Bank. In determining the maximum amount of foreign exchange to be distributed to commercial banks, the Central Bank observes two magnitudes, namely: the rate of growth in imports and the situation of the balance of payment. This division of foreign exchange to banks happens twice a year.

5.6. Foreign Exchange Regulations

The foreign exchange regulations are laid down in the Foreign Exchange Ordinance of 1940. This ordinance, established during the second World War, prohibited all financial transactions with other countries unless a license has been granted.

After the World War and especially during the 1960s, it became evident that these measures were obsolete, and as a result the foreign

exchange authorities granted more freedom to the process of external payments.

Banks are permitted to provide foreign exchange for most of the current transactions. Foreign exchange rates are quoted on a daily basis by the Central Bank. The Netherlands Antilles guilder is pegged to the U.S. dollar. The fixed rate for a dollar is Naf. 1.78 when banks buy drafts and checks, and Naf. 1.81 when banks sell banknotes, drafts and checks.

Banks buy dollar banknotes at a fixed rate of Naf. 1.77 for one dollar. All local deposit banks are authorized by the Central Bank to deal in foreign currencies, and when dealing with the public they apply the official rate. Dealings between the Central Bank and deposit banks mainly occurs in U.S. dollars and generally at the interbank rate of Naf. 1.80 for one dollar. Foreign exchange held by residents must be handed over to an authorized bank, although this is flexibly interpreted in order to accommodate tourism.

The regulations on the current account are less restrictive than those on the capital account in order to accommodate trade.

5.6.1. Current account regulation

In the Netherlands Antilles, there are less restrictions on the current account than on the capital account. The reason is that almost everything has to be imported. Too many restrictions, therefore, would impede the trade sector from functioning smoothly. Hence, businessmen, under a general license, are not restrained to a certain

amount of foreign exchange, but can make their payments for legally imported and exported goods freely and also finance their inventories or the insurance of goods.

Payments for most current invisibles (services), up to an equivalent amount of Naf. 50,000, are also not restricted. However, the bank has the authority to inquire for which purpose the money will be used, in order to prevent the abuse of the before-mentioned privilege which might lead to depletion of foreign exchange.

The foreign exchange directive 1983/4 allows residents to buy foreign exchange for payments to nonresidents, or to sign contracts with nonresidents, up to an amount of Naf. 50,000 each time without permission of the Central Bank. The latter, however, may not exceed Naf. 250,000 per year. In case residents want to buy an amount which exceeds the latter, then permission from the Central Bank is required. Examples of such payments are: wages, salaries, telecommunication, tantiemes, rents, industrial costs.

Some other restrictions on current account transactions are related to tuition or educational expenses, costs of living expenses, hospital expenses and the like. For example, residents whose children are studying abroad are allowed to remit to their children an amount of Naf. 10,000 each time, up to a maximum of Naf. 50,000 per year. Permission is required in case the amount exceeds Naf. 50,000 per year.

The foreign exchange directives of 1985/1 also restrain the amount

of foreign exchange that residents can take with them when going on vacation. Residents can buy Naf. 200 per person for each day spent abroad. The maximum amount that they can spend, in a year, on vacation is Naf. 10,000, without permission of the Central Bank. These regulations were imposed as enormous amounts of foreign reserves were leaving the country. The Central Bank suspected that uncertainty about the political structure of the Netherlands Antilles ("Status Aparte" of Aruba and the distrust in Aruba's own currency), the economic recession that set in during 1983 and continued in 1984, the huge government deficits during the past two years as well as the closing of the Lago (Exxon) oil refinery in Aruba (its main economic pillar) as well as uncertainty about the future of the oil refinery in Curacao (Shell Curacao N.V.) induced expectations of a devaluation of the Antillean guilder and caused many residents to get out of the local currency into foreign currency under the pretext of going on vacation, to safeguard their wealth in foreign banks.

Residents are allowed to make interest payments to nonresidents provided that the loans were obtained from the nonresidents (after a foreign exchange license had been granted). Trading companies in the Netherlands Antilles are also allowed to maintain accounts expressed in foreign currencies with domestic banks. The banks also provide loans and overdrafts expressed in foreign currencies, mainly U.S. dollars.

Although many current account transactions can be made freely,

up to a certain amount, the situation for capital account transactions, however, is different as will become evident in the next paragraph.

5.6.2. Capital account

All capital account transactions need a permission from the Central Bank. This measure has been taken to prevent an outflow of international reserves. However, the restrictions are not such that it would inhibit capital mobility which in turn would frustrate foreign investment, which also requires a license, but allowed whenever it is in the socio-economic interests of the islands.

Residents under certain conditions are allowed to buy foreign securities. The buying of these securities has to take place by means of a local deposit bank, and the amount that can be invested in- to foreign assets may not exceed the amount of Naf. 50,000 per year (foreign exchange directives 1982/1). The authorized local deposit bank registers all these foreign assets, and in this way the Central Bank has some control over the total amount of foreign assets. The advantage for the Central Bank is that in an emergency situation (assume a depletion of all international reserves), the bank can order the deposit institution to sell off these foreign securities, and to turn out the proceeds in Netherlands Antilles guilders to the holders of the before-mentioned securities. The purchase of mutual funds, however, is prohibited, and residents are also not permitted to borrow in the domestic market and then take the obtained funds to buy

foreign assets.

In order to prevent foreign liabilities from becoming too high, the Central Bank prohibits residents from making foreign loans without their permission. For example, if a resident wants to buy a house in Miami, and wants to take a mortgage at a bank in Miami of \$95,000 then this resident needs a permission from the Central Bank, and the amount of \$95,000, is recorded in the balance of payment as a foreign liability.

The Central Bank does allow residents to have a time deposit in a foreign bank (note: residents need a permission first). Residents who have such deposits abroad, must report to the Central Bank every quarter, and they are not allowed to become debtors. The Central Bank must know in which foreign bank the money is deposited, and these arrangements have to be channeled through an authorized local bank. The time span of these deposits varies between six months and one year. The Central Bank allows residents to avail themselves of this opportunity due to the lack of a local sophisticated money market instruments with high yields.

On every amount of money that leaves the country, there is a foreign exchange tax of 1.3%.

Investment companies in the Netherlands Antilles whose stockholders are living abroad can, with permission of the Central Bank, remit the profits to the shareholders.

Residents other than the monetary authorities and authorized

industrial users are not allowed without special permission to hold or acquire gold in any form other than jewelry or coin, at home or abroad.

Imports and exports of gold in any form other than jewelry require a license granted by the Central Bank. Such licenses are not normally granted except for imports and exports of coin by authorized banks, and for imports and exports by or on behalf of the monetary authorities and industrial users.

Institutional investors (pension funds and life insurance companies) in the past used to invest almost all their funds abroad, due to absence of a capital market, and abroad the risk could be spread better and obtain higher returns on investment, which in turn benefitted their depositors. In order to have some of this money remain in the Netherlands Antilles, the Central Bank required the pension funds to invest 40% of their total assets domestically and 60% abroad. For life insurance companies, the directives are somewhat different. The list on the next page gives an illustration of required percentages. In itself, this effort of the Central Bank is good; however, there is a flaw in this directive, namely, the Central Bank does not tell these investors in which direction the domestic investment should flow. As a result, most of this domestic investment does not flow to productive investment projects that can create long-term employment and income but to low risk areas (mortgages).

Amount of liabilities	Minimum amount to be held in Netherlands Antilles investments		
	%	Amount (millions)	Total amount (millions)
First 10 million	40	4	4
Second 10 million	50	5	9
Following amounts	60	60% of remainder=r	9+r

5.7. Monetary Policy in the Netherlands

Antilles

Monetary policy is just one aspect of overall economic policy. The supervision on financial institutions, with the main purpose of controlling the money supply and to maintaining the stability of the Antillean guilder, might be looked upon as a particular form of the government's intervention in the economic process. Therefore, the objective must be regarded as being part of overall economic objectives.

The Bank van de Nederlandse Antillen, the Central Bank, monetary analysis focuses on two magnitudes, namely:

- 1) The quantity and composition of the money supply and,
- 2) International reserves (Snoek, 1981).

Both are very important for maintaining the external stability of the Netherlands Antilles guilder. Hence, the Central Bank's policy tends toward the monetarist view which emphasizes the role played by the quantity of money.

The money supply in the Netherlands Antilles consists of money and near money (broad definition). Money is defined as currency in circulation, demand deposits or checking accounts of the Island Governments and the private sector held with the money creating banking institutions. The latter comprises:

- 1) The Central Bank,
- 2) Commercial banks,
- 3) Giroservice of the Island of Curacao,
- 4) The Central Government by issuing coins.

Demand deposits expressed in Netherlands Antilles guilders, and held by the offshore companies to cover domestic payments as a result of personnel expenditures, rent and office costs, are also included in the definition of money.

The foreign currency demand deposits of residents at domestic banks are also included. These demand deposits can be converted into Netherlands Antilles guilders at any time. But foreign currency cash holdings are not included (Beers, 1980).

Near money consists of time deposits of the Island Government plus time deposits and savings deposits held by the private sector with the Central Bank, and the private deposit banks. Time deposits are included irrespective of their maturity date. The moneyiness of savings deposits in the Netherlands Antilles is very high as savers use their savings deposits as current accounts.

Deposits that are securities for loans are excluded from the

definition of money, as are savings and time deposits at secondary or nonmoney-creating institutions.

Factors which affect the money supply are the Central Government, Island Government, private sector and money-creating institutions, as well as foreign exchange reserves.

The Central Bank closely observes changes in domestic credit and foreign exchange reserves (monetary base). In the Netherlands Antilles, an increase in the money supply increases the domestic price level slightly, but as a result of the small domestic production, the smallness and openness of the economy leads to an increase in imports and consequently a decrease in international reserves.

Hence, we might say that there is a strong inverse relationship between domestic credit and international reserves in the Netherlands Antilles. As a result, the Central Bank tries to regulate the expansion of bank credit in order to obtain a balanced growth of the money supply in comparison with national income and to maintain a balanced balance of payment.

To influence the money supply, central banks have different policy instrument at their disposition. These policy instruments can be divided into general or quantitative policy instruments, and selective or qualitative control instruments.

General controls are techniques used by the Central Bank to determine a country's total money supply, and affect financial conditions in general. The use of these instruments does not discriminate

among the various financial submarkets such as consumer finance, real estate finance, and business finance. Changes in these instruments, rather, establish an overall framework of monetary ease or tightness for the economy as a whole and individuals in the economy are then left free to adjust to this framework in a manner most suited to their own circumstances.

The most common general controls are:

- 1) Open market operations,
- 2) Discount policy,
- 3) Variations in reserve requirements.

5.7.1. Open market operations

The purchase and sale of government securities by a central bank is known as open market operations. These transactions are conducted on an organized market, and they are one way by which a Central Bank can alter the total of its assets and, hence, of its liabilities.

5.7.2. Discount policy

When commercial banks borrow from the Central Bank, the commercial banks' liquidity or reserves increase by an amount equal to the borrowings. When previous borrowings are repaid, bank reserves go down. The Central Bank can affect the total volume of such borrowings by raising or lowering the rate of interest charged to commercial banks, and this rate is called the discount rate and the policy, discount rate policy.

5.7.3. Variations in reserve requirements

The original purpose was to protect depositors by ensuring some minimum level of bank liquidity. In countries without broad and active financial markets, this has been a very effective instrument. Increases in the required reserves act as a restraint on bank lending. Decreases serve to encourage an expansion of bank credit. Changes in required minimum cash reserve ratios can be used for monetary control in countries where open market operations are likely to be an inefficient instrument of monetary policy.

5.7.4. Selective controls

In addition to general controls, central banks also have selective controls. The purpose of the selective instruments is to affect particular sectors of the economy on a selective basis. They may be used either to reinforce a more general policy or to shield a particular sector from the Central Bank's general policy. The most widely used selective controls are:

- 1) moral suasion,
- 2) consumer credit controls.

5.7.5. Moral suasion and consumer credit controls

Moral suasion is a general term describing a variety of informal or nonlegal methods used by the Central Bank to persuade commercial banks to behave in a particular manner. The objective of moral suasion is typically to restrain the growth of bank credit (loans) going into particular sectors of the market.

The purpose of consumer credit controls in many instances is to stop an existing price inflation.

In the Netherlands Antilles, the Bank van de Nederlandse Antillen has both general and selective credit controls at its disposition. However, the selective credit controls are the most widely used policy instruments. In fact, for a long time, moral suasion, by way of the use of gentleman agreements, were used to induce banks in raising or lowering domestic credit.

The policy instruments that the Central Bank has to influence the money stock are:

- 1) open market operations,
- 2) discount policy,
- 3) direct credit regulation policies.

5.8. Policy Instruments of the Bank van de Nederlandse Antillen

As mentioned before, the three policy instruments of the Bank van de Nederlandse Antillen are: open market operations, discount policy, and direct credit regulation.

Open market operations can be conducted only if there is a satisfactory market for assets. The lack of a sophisticated local money market, and the absence of a capital market, have made open market operations an ineffective tool for implementing monetary policy.

The Bank van de Nederlandse Antillen does not have a portfolio of treasury paper, necessary to conduct open market operations, even though these securities have been issued since 1977. The Central Government prefers to take advances at the Central Bank as they do not have to pay interest on them, while by issuing bonds or treasury paper, they must pay interest to the holders of bonds or treasury paper.

In order to prevent excessive monetary financing, as this causes money to expand directly by an increase in the monetary base, the Bank van de Nederlandse Antillen does not want to hold a portfolio of treasury paper and moreover they have put a limit on the Central Government financial requirements. The Central Government, by agreement, cannot exceed the maximum of Naf. 110 million on its advance account at the Central Bank. The problem is that the Central Government does not issue treasury paper to promote the development of a local money market or to foster open market operations, but to finance deficits.

On January 1, 1984, the Central Bank relaxed its position with respect to portfolio paper to reduce the opportunity cost related to the excess reserves of commercial banks. Commercial banks, in the absence of investment opportunities, might decrease the interest rate on deposits, which in turn, would discourage saving and encourage dissaving, in order to reduce their excess reserves that could not be invested.

For example, during the first six months of 1983, the interest rates decreased due to excess liquidity. On December 31, 1982, the average prime rate and mortgage rate were 11.4% and 12.8%, respectively. But at the end of June 1983, these interest rates were .3 and .4% lower than on December 31, 1982. The average interest rate on the time deposits also declined from 7.1% to 6.3% during this period.

To prevent these shifts in the interest rate on deposits and to have banks earn some interest on their excess reserves, the Central Bank created the possibility for commercial banks to buy with their excess reserves, certificates of deposits, with a maturity of one month and an annual interest rate of 5%. The face amount of one certificate of deposit is Naf. 50,000. The benefit of this short-term instrument is that it allows the Bank van de Nederlandse Antillen to reduce the excess liquidity of commercial banks. The latter can buy these certificates of deposit with their excess reserves and earn interest.

The Central Bank is also a lender of last resort to commercial banks. The discount rate is 8%. However, the effectiveness of discount policy depends on the dependence of commercial banks on the Central Bank. The more liquid banks are, the less their dependence on the Central Bank for assistance and consequently the less the Central Bank's effectiveness in regulating credit by way of this instrument. This is exactly the case in the Netherlands Antilles. Commercial banks

are very liquid. Thus, whether the Central Bank raises or lowers the discount rate, the effect of it on commercial bank lending is minimal.

The reasons why commercial banks in the Netherlands Antilles are very liquid are as follows.

Commercial banks in the Netherlands Antilles manage to mobilize large amounts of savings deposits as there is little or no competition between commercial banks and other savings institutions. In the United States, for example, there is stiff competition between commercial banks, savings and loan associations, mutual savings banks, and credit unions. In the Netherlands Antilles, this is not the case anymore.

The reduction in investment due to the economic recession also lowers the demand for loans, leaving the banks with more liquid funds.

The fact that banks cannot invest all their excess reserves in foreign assets, because the Central Bank imposes a limit on the amount to be invested abroad, is another cause of excess reserves for commercial banks. And, last but not least, are the large transaction accounts of the island governments held at commercial banks. Most of the funds on these accounts come from profit taxes received from the offshore sector and oil refineries. Hence, the effectiveness of discount policy is weak. Sometimes, commercial banks do follow the Central Bank when the latter raises or lowers the discount rate, but then the driving force has been moral suasion, which causes commercial banks to lower or to raise the interest rate on deposits or mortgages.

With the two instruments of altering discount rates and engaging in open market operations almost paralyzed, direct credit regulation and indirect credit regulations by using different reserve ratios, depending on the type of deposit or asset, have become the most widely used type of policy control instruments. The latter will not be explained again as it has already been explained in paragraph "Liquidity."

Before 1970, the Central Bank was a circulation bank, foreign exchange bank, and banker for the Central Government, and monetary policy was not considered important. However, the rapid economic change and expansion of credit during the '70s as a result of social welfare improvements, wage increases, inflation and the demand for investment to rebuild the city after the labor revolution of May 30, 1969 forced the Central Bank to apply credit restrictions for the first time. These restrictions were imposed by way of gentleman's agreements. When the Central Bank uses direct credit policies they differentiate between productive credit and consumptive credit. In times of balance of payment deficits, the Central Bank usually imposes restrictions on consumer credit in an effort to curtail the use of credit for consumer purposes, which in turn might lead to higher imports reinforcing a trade balance deficit, and a drain on the so-needed foreign reserves, important to the external value of the Antillean guilder.

5.9. Factors Constraining Monetary Policy of the Central Bank

In many developed countries, the Central Banks are concerned with controlling the money supply, preventing inflation and high unemployment and the like.

In the Netherlands Antilles, due to the openness of the economy, fixed exchange rate, and small domestic production, there is a link between the money supply and the balance of payments. A disequilibrium in the money market causes a disequilibrium in the domestic goods and service market and a disequilibrium in the balance of payment. The stock market can be excluded as there is none. For instance, an increase in the money supply (say a rise in domestic credit) causes people to have more funds, hence, they want to dispose of these funds, and as a result, the demand for domestic goods and foreign goods rises. However, the demand for foreign goods rises much faster than the demand for domestic goods as domestic production is almost insignificant. Consequently, the rise in the domestic price level is small. But the rise in imported goods is large. This fact is immediately reflected in the balance of payments (trade balance), and as these foreign imported goods must be financed with foreign exchange, it also depletes the stock of international reserves, endangering the stability of the Antillean guilder. Thus, the balance of payment in the Netherlands Antilles is like an "open window." People dispose of their excess funds through the balance of payments. It is easier for the Central

Bank to control domestic credit than to control international reserves. The inflow of international reserves is a function of the tourist sector, oil sector, transportation, offshore sector, and foreign development aid.

A world recession immediately affects the oil sector, tourist sector, and transportation sector in the Netherlands Antilles. Any adverse development in the offshore sector in the Netherlands Antilles can affect the inflow of foreign exchange. And these four sectors are the main foreign exchange generators of the Netherlands Antilles. However, the Central Bank has no control on the inflow of foreign exchange from these sectors as the inflow depends on world developments, or exogenous forces. Also, the inflow of foreign aid depends on the donor countries, hence, beyond the Central Bank's control. Another problem is that the U.S. dollar is freely used in the Netherlands Antilles, and in St. Maarten it has almost replaced the Netherlands Antilles guilder. What the Central Bank can do is try to regulate the outflow (see foreign exchange regulations), and even that is not waterproof.

Hence, the only component of the monetary base on which the Central Bank has some more control is domestic credit. In this credit approach, the Central Bank recognizes and stresses the interdependence between the balance of payments and the moneystock. The lack of a developed money market and absence of a capital market and the high liquidity of commercial banks are other problems for the Bank's monetary policy as they inhibit the effective use of open market operations and

discount policy. The restrictions on consumer credit, in order to curtail consumer spending and to promote productive investment, are less effective as there are no guidelines to which productive investments they ought to be directed. Moreover, there is a lack of commercially viable investment projects, and banks have a demand-following approach, and the government does not have "high priority" areas that could be used as a guideline for productive investment funds.

Even though the Central Bank imposed a limit of Naf. 110 million that the Central Government could withdraw from its advance account, it can still be considered doubtful whether the Bank will be able to enforce this limit on the Central Government in the event of any increasing need for financing on the part of the Central Government, due to the fact that the Central Bank is obliged to fulfill the request for an advance by the Central Government in case the latter requests it.

Another fact that hampers the Central Bank's monetary policy is the fact that the island governments prefer to maintain large accounts at the local commercial banks, to be used as transaction accounts, rather than to maintain them with the Central Bank where they can earn interest on these funds. These funds, as mentioned before, are obtained from profit taxes, received from the oil refineries and offshore sector. The effects of holding such large accounts at the local commercial banks is that they supply these banks with excess liquidity. By using these funds for transaction purposes, they highly affect the money

supply. Consequently, there arises a conflict between the Central Bank's monetary policy and the government's expenditure behavior, namely, while the Central Bank is trying to control the money supply by selling certificates of deposit and imposing credit restrictions, the Island Governments are expanding the supply of money by holding large accounts for transaction purposes, supplying these banks with excess reserves. In this way, they frustrate the use of discount policy even more. To make monetary policy in the Netherlands Antilles more effective, both the Central Government's and the Island Government's expenditure behavior have to be changed.

5.10. Summary

Summarizing the financial sector, we find that the Netherlands Antilles have a very well developed financial system. Only two banks are completely locally owned. All the others are affiliated with a foreign bank.

These commercial banks provide all modern banking activities, and are the largest financial intermediaries in the Antilles. Commercial banks manage to mobilize most of the savings deposits and this type of deposits is also their largest source of funds.

The savings deposits are used as current accounts and hence their turnover is very high, which in turn constrains the banks from making medium-term and long-term lending. As a result, banks concentrate on short-term lending to finance imports, exports, inventories and transport.

Commercial banks in the Netherlands Antilles are very liquid, and most of their loans are directed toward wholesale and retail trade and individuals for consumption purposes. A very small percentage of their total loans are directed to manufacturing and agriculture. Thus, their investment flows to low risk areas. Banks are conservative and risk averse. The high liquidity of the banks makes the development of an interbank market redundant. Their foreign assets also exceed their domestic assets due to a lack of viable investment projects and absence of a local capital market, and abroad the interest yield is higher and risk spread better.

The offshore sector is a very important foreign exchange generator. This sector provides the government with substantial amounts of profit taxes and generates employment, especially in Curacao where most of the offshore companies are situated.

The withholding tax repeal on interest in the United States had a negative impact on the financial offshore in Curacao. Hence, the future of the financial offshore is uncertain. This, in turn, will have its negative impact on the rest of the economy. Future possibilities may lie in the attraction of foreign sales corporations, shipping companies or a development of an offshore stock exchange.

The Giroservice is owned by the Government of the Island of Curacao, and its main function is supplying the latter with liquid funds.

Pension funds foreign assets exceeds their domestic assets. In

1982, foreign assets comprised 65% of total assets, due to the same reasons as mentioned about commercial banks. Life insurance companies' share of foreign assets in total assets is smaller. The domestic investment of these institutional investors also goes into low risk areas like mortgages.

Credit unions are divided into district or barrio credit unions, and industrial or professional credit unions. The industrial credit unions have been growing at the cost of the district credit unions. The lack of expertise in how to manage a credit union financially caused many delinquent loans in the barrio credit union. Even though credit unions should foster saving, the main reason for members to be in a credit union is to be able to borrow at low cost. Credit unions in the Netherlands Antilles are not of vital importance in the financial development of the Netherlands Antilles.

The Ontwikkelings Bank van de Nederlandse Antillen (Development Bank) provides the long-term funds needed for agricultural projects and the like. The governments have the majority of the shares, and the commercial banks also have shares in the development bank. This bank, which is still young, can play an important role in the development of the Netherlands Antilles. The bank finances projects up to a maximum of Naf. 500,000, with an interest rate varying between 9 and 12% for the industrial sector, tourism and transport sector. For agricultural projects, the interest rate is 7%.

The money market is situated at the commercial banks but is still

underdeveloped. The most widely used instruments are time deposits and savings deposits. These deposit facilities are offered to individuals, firms, and corporations. The government issues treasury paper, but mainly they are bought by banks. There is no capital market in the Netherlands Antilles. The capital market did not develop as many business enterprises are sole proprietorships, and in case they need loans to finance their business they can get it at commercial banks. Corporations do not issue bonds, they mainly finance their corporation with retained earnings or funds from the mother company, and their funds can have higher yield in foreign capital markets at less risk. The smallness of the market is also hampering the developments.

The Bank van de Nederlandse Antillen is the Central Bank of the Netherlands Antilles. This bank is the oldest Central Bank in the Caribbean. The bank is relatively independent of the government and is mainly concerned with controlling the quantity and composition of the money supply, and international reserves which in turn is important for the external stability of the Antillean guilder. The instruments to its use are open market operations, discount policy, and direct credit regulations, as well as indirect (solvency requirements and liquidity requirements). The use of discount policy has been ineffective due to the high liquidity of the commercial banks. Open market operations have been less successful due to the nature of the market and the fact that the Central Bank does not have a portfolio of govern-

ment security paper (to prevent more monetary financing). The treasury paper that is issued is used to finance government expenditures. Later, the Central Bank developed a rudimentary form of open market policy by allowing banks to buy certificates of deposit at an interest rate of 5% annually. By way of this measure, they are able to contract or expand the liquidity of banks.

5.11. Remarks

The main problems the Netherlands Antilles have been facing for the last few years are:

- 1) High unemployment, especially on the Leeward Islands. On the Windward Islands there is less unemployment; especially St. Maarten has been doing very well. This island has been experiencing rapid growth in the tourism industry, offshore banking sector, construction and industrial activities (Antillen Review, 1985b).
- 2) A decline in economic activity in the major economic pillars of the Netherlands Antilles, namely, oil refinery, transport, tourism and offshore sector. The reason for this decline in economic activity is due to the excess oil refining capacity in the world markets, world recession, devaluation of the bolivar, and withholding-tax repeal on interest for nonresidents in the United States. The effects of these developments were mostly felt by the Leeward Islands.
- 3) High budget deficits, threatening the external stability of the Netherlands Antilles guilder.
- 4) Uncertainty about the future operations of Shell Curacao N.V. due to excess oil refining capacity in the world. Note: The oil refinery is the main economic pillar of the Antilles. Thus, uncertainty about its future establishment on the Netherlands Antilles will create instability in the economy. Note that economists estimated that a closing of Shell Curacao N.V. would reduce national income by 50%. The macro-economic effects of such an action are obvious.
- 5) Narrow production base.

With respect to savings and investment, there have been many theories. The classical or neo-classical economist considered prior savings to be the most indispensable condition necessary for investment. However, the decision to save and to invest are not interdependent, but independent. The fact that accumulation of savings should precede additional investment is characteristically only of an extremely primitive economy in which savers and users of savings are invariably the same, which however is not so in most of the developing countries (Khatkhate, 1972).

In the Netherlands Antilles, there is no paucity of savings. The commercial banks managed to mobilize large amounts of savings from the household sector, and so did the pension funds and life insurance companies.

However, these savings do not flow to the right type of investment (productive) in the Netherlands Antilles, but to the wrong type of investment (mortgages and foreign assets). Although investment in mortgages provide more housing for the population and investment in foreign assets enhances the security of the depositors, from a macro viewpoint they have little beneficial impact on growth as they usually don't create long-term employment and income. The long-term funds of institutional investors should be channeled to those investors (locally) that need these funds and will use it the most effectively.

The commercial banks, whose main resources comprise savings deposits, are concerned with self-liquidating loans to the wholesale

and retail trade sector. These loans are mainly short-term due to the nature of savings deposits. The proportion out of total loans that goes to the manufacturing sector and agricultural sector is very small. The velocity of savings is very high, indicating that savers are not willing to forego present consumption for future consumption.

The complaints of institutional investors and commercial banks coincide. Both complain that there is a lack of viable domestic investment projects, that abroad the yield on their invested funds is higher, and that the risk diversification is better.

Hence, changes are required. The mentality of savers should be changed to allow banks to make medium-term lending and long-term lending. Savers should be made aware of alternative ways of holding assets. Commercial banks might provide financial assets for the surplus sectors to hold their transferable savings in other types of domestic financial assets with a higher yield. This would expand the narrow money market size.

What is more at the center of things is that a channel is required through which these surplus funds (savings) of the household sector can flow to those that need the funds.

This channel, however,

- 1) needs the investors' and financial intermediaries' confidence, due to their risk aversion and conservatism,
- 2) have the expertise in analyzing and appraising projects,
- 3) its operation should be consistent with the government's high priority areas,

- 4) and operate in connection with the Central Bank,
- 5) should be supply led.

The government policy of not keeping expenses in line with revenues has led to enormous deficits in the past two years. This situation has been aggravated by the recent decline in government revenues from the oil, tourism, and transport sectors for reasons as mentioned before. The deficit was reinforced by deficits from the Curacao Dry Dock Company (C.D.M.) and the national carrier, The Antillen Airline Company (A.L.M.).

To finance these deficits, the government relies heavily on advances from the Bank van de Nederlandse Antillen and credit from the private sector. The selling of government securities, bonds and treasury paper is called monetary financing in economic jargon. This way of financing a deficit causes some problems in a small open economy such as that of the Netherlands Antilles.

By selling treasury paper to the public, the government, in fact, increases the money supply, since treasury paper is highly liquid. Hence, this paper can be easily resold to the banks, and the public can obtain money that could be spent on goods and services.

By selling bonds to the public, the government decreases the available credit to the private sector, but by using the obtained funds in nonproductive activities (financing of expenditures like wages, salaries) instead of productive investments, the money returns into the hands of the public, and raises their disposable income and increases

their demand for goods and services. The demand for goods that cannot be satisfied domestically must raise imported goods and, as a result, the international reserves decrease. The use of advances from the Bank van de Nederlandse Antillen has the same expansionary effects.

Looking at this monetary financing of budget deficits in another way, another conclusion can also be drawn. If the total amount of nominal wealth of the private sector is considered to consist of money, government bonds, and government treasury paper, then a funded deficit will affect the level and composition of nominal wealth. By increasing the value of government debt outstanding, a funded deficit raises the level of real wealth of the private sector, given a certain rate of inflation. By having more wealth, aggregate demand will increase (wealth effect). Continued deficit funding in this manner will reach a point where the private sector does not want more government security paper or want less of it, reducing the aggregate demand. Now, for the government to still be able to place these securities with the public sector will require a higher interest rate to make them attractive. In turn, this higher interest rate will depress investment and reduce aggregate demand.

High budget deficits and too much monetary financing in a small open economy with a narrow production base, and a government whose revenues are soaring due to adverse developments in the major economic pillars, will reduce investor's confidence and reinforce their reluctance to invest, awaken expectations of a devaluation of the Antillean

guilder, cause residents to shift into foreign currency holdings and lead to social unrest.

The Central Bank hardly uses the open market policy and discount policy for reasons already mentioned. More effective have been the indirect credit controls, like solvency requirements and liquidity requirements. Some comment could also be made on the consumer credit restrictions, imposed by the Central Bank, in times of balance of payment deficits.

Even though restricting consumer credit is a good step to prevent foreign exchange exhaustion, it must be said that it has some flaws. When one source of borrowing is restricted (consumer loans), then borrowers will obtain the funds they desire from other sources, or they may change the stated purpose of their borrowing. For instance, borrowers can simply reduce their marginal propensity to save, and still be able to import their consumer goods, or they can resell their government securities, treasury paper, or resell their foreign assets in the foreign secondary market and still obtain the funds to buy their products. In the Netherlands Antilles, if the loans cannot be obtained from the commercial banks, then they can be obtained from the barrio credit unions or professional credit unions or by buying illegal lottery (number). Hence, the effectiveness of consumer credit restrictions in the Netherlands Antilles depends on:

- 1) the wealth position of the borrowers, and
- 2) availability of alternative sources of funds.

Restricting consumer credit to enhance productive credits also has its flaws. The fact that commercial banks are profit maximizers means their understanding of productive investment may be different from that of a macro-economic planner. For a commercial bank, productive investment can mean investing in areas with low risk and high return. In general, commercial banks do not take into consideration the external benefits which expansion in the "high-priority" sectors will yield for the rest of the economy. In the Netherlands Antilles, it becomes evident that commercial banks always looked for low risk areas. The banks have concentrated heavily on short-term, self-liquidating loans to finance foreign and domestic commerce. Medium- and long-term loans, especially for the financing of manufacturing and agriculture, have largely been neglected. Hence, it is clear that the Central Bank of the Netherlands Antilles should be endowed with additional powers to direct the flow of funds to other areas of the economy that will help to fortify the economic base. With respect to supervision, it is necessary that this task be expanded to examining banks as this will enhance the confidence of the public in the financial system. The qualified bank staff should train personnel to become bank examiners to check the portfolios of outstanding loans of these commercial banks.

5.12. Some Comparisons

If we compare fiscal policy to monetary policy, then certain conflicting situations arise that should be changed or adjusted. For

example: The Central Bank tries to control the outflow of international reserves and to regulate excessive domestic credit. But when we look at government expenditure policies, we notice that the government is taking credit to finance deficits by selling highly liquid treasury paper and bonds and taking advances from its advance account at the Central Bank. These actions indirectly increase the money supply, and in an open economy with a fixed exchange rate and small production base, the balance of payment becomes an "open window" and hence international reserves declines.

Another fact is that the Central Bank, by selling certificates of deposit, tries to reduce the excess reserves of commercial banks, but on the other hand, the Island Governments when receiving profit taxes from the offshore sector and oil sector maintain these funds at commercial banks for transaction purposes and increase the liquidity of these institutions, and the money supply.

The government should allow the Central Bank to use treasury paper as a monetary control instrument to contract or expand the money supply whenever this is deemed necessary. Yet, it is used to finance expenditures. Another situation is that the institutional investors are the possessors of long-term funds. The Development Bank needs long-term funds and depends on foreign assistance for these funds. However, the institutional investors do not have shares in the development bank.

The quasi-government institutions could issue bonds to develop

a small capital market and raise from the issuance of bonds their needed funds. However, they rely on loans from the commercial sector and subsidies of the government, which in turn crowds out government revenues.

The current liquidity regulation of the Central Bank prevents banks from being unable to fulfill a withdrawal on demand, but on the other hand, these same regulations encourage banks to focus on short-term lending. It is like a two-edged sword.

5.13. Conclusion

From the before-mentioned remarks and comparisons, it becomes clear that there is no consistency between the government policy and that of the monetary authorities. Government's behavior weakens the effectiveness of the Central Bank's monetary policy instruments. Another problem is that there is a lack of coordination between the Central Government and Island Government which is reflected in the revenue sharing agreement between the former and the latter. The government does not have a development program in which the high priority areas are clearly defined. Moreover, the high deficits are frustrating investments. The financial sector is too risk averse and should become more venturesome.

5.14. Suggestions

As mentioned before, economic growth has been grounded in the Netherlands Antilles, especially on the Leeward Islands. Investment

does not take place due to lack of long-term funds, lack of viable investment projects, uncertainty about the political future of the Antilles, and continuity of the oil refinery.

However, there are sufficient savings at commercial banks and institutional investors. The nature of the former's savings is short-term and the nature of the latter's savings is long-term. Thus, funds for investment are present. But institutional investors and commercial banks are conservative and risk-averse, and investors are reluctant to invest due to the economic conditions of the country.

Savings depend on income, and efficient investment depends on entrepreneurial talents, knowledge, and willingness to take risk. With no investment, all sectors including the financial sectors will be affected; national income will decline, unemployment increase, and savings and social welfare will drop.

In order to eliminate investor reluctance, and commercial bank and institutional investor risk aversion and conservatism, certain adverse conditions have to be changed, and a channel must be found to channel the savings of the household sector to the most efficient investors.

The first change that has to be made is for the government to create a better investment climate. This means that government expenditures must be reduced. A limit should be imposed on the maximum amount of their expenditures. The government will have to readjust the wages and salaries of government employees, as these wages and

salaries give a distorted view of reality when compared with the economic situation. The automatic wage indexation will also need reconsideration, as will the Dismissal Law, if the Netherlands Antilles want to be able to compete with other nations in the Caribbean where wages are much lower and consequently factor costs lower. Due to the high dependence on foreign goods, there is imported inflation. Thus, the goods should be imported from other countries than the United States, where the products can be bought cheaper and in this manner prevent the continuous adjustment of wage indexation due to imported inflation.

A reduction of the budget deficit will reduce the threat of external imbalance and increase investor confidence, reduce the expectation of a possible devaluation, curtail the outflow of funds into foreign assets, and enhance political stability.

The quasi-government enterprises or institutions should be urged to issue their own bonds to raise needed funds, and to adjust to changing market conditions in time. Government support should be used for transitory difficulties and should be accompanied by efficient measures that will help these enterprises to viability without government support.

The ill-functioning revenue-sharing agreement should be reconsidered. When an island, which is now exempted from the tax revenue sharing agreement, is doing economically well, as is the case with St. Maarten nowadays, then it should pay tax. The collection of taxes by the government also has to be improved. Arrears in tax collection

reinforces the government's need to rely heavily on monetary financing and on Central Bank credit.

The declining revenues of the government will force the government to raise taxes on certain articles if it wants to be able to cover its expenditures in the future. Restrictions imposed by the Central Bank to curtail consumptive credit, in connection with a tax increase on certain imported goods, can make the credit restriction of the Central Bank more effective, especially if it is imposed on luxury goods such as cars and televisions and the like.

Another suggestion is that the Central Government should not use treasury paper as a primary instrument to finance short-term expenditures, but leave it to the Central Bank to be used in open market operations to reduce banks' excess reserves.

Another important step of the government should be the development of a development program. Absence of a clearly defined development policy is like leaving the harbor without destination. A development program can serve as an indicator showing to which projects the funds (development aid) should be directed. Beside the government, the financial intermediaries also have to change the nature of savings.

The development of other domestic financial assets, with higher yields and expressed in Netherlands Antilles guilders, may contribute to the expansion of a small domestic money market, especially if the newly developed instruments contain a degree of liquidity and other

characteristics similar to those abroad. The amount of savings will also increase, if savers, through a marketing program, are made aware of the benefits associated with holding their wealth in forms other than passbook savings. It should not be lost sight of that these instruments should be consistent with the savings preferences of the household sector. The advantages of creating a domestic instrument with foreign characteristics is that it may temper the outflow of capital. The obtained funds from the increase in savings should be channeled to the productive investment areas that will create long-term employment and improve the economic conditions of the country.

Due to the absence of a capital market, where those who have funds meet those who need funds, another channel has to be looked for. The best equipped institution to fulfill this function is the Ontwikkelings Bank van de Nederlandse Antillen (The Development Bank of the Netherlands Antilles). They can set up a design and project promotion unit; they possess the necessary technical skills and expertise to select, analyze, and appraise any project from a commercial as well as an economic viewpoint; by designing a marketing plan, they can promote the island abroad to attract foreign enterprises; their development program takes into account national interest and regional interest; they are in a position which allows them to pool the resources from commercial banks, institutional investors, government, and foreign sources of funds. If the development bank is used as a channel to bring together the suppliers of funds and those who need the funds,

then the problem of insufficient viable projects can be eliminated, especially if the Development Bank uses a supply-leading approach. The use of resources, especially entrepreneurial talents and managerial skills, and the costs of explicit or implicit subsidies in the supply-leading approach of the Ontwikkelings Bank (Development Bank) should produce sufficient benefits in the form of stimulating real economic development for this approach to be justified, as this approach has its dangers with it. The conservatism and risk aversion of financial institutions may be tempered, and the bottleneck of long-term funds eliminated, especially if the Central Bank is given the powers to force the institutional investors like the pension fund to invest its required 40% of domestic investment into the approved projects of the Development Bank. Right now, it is my impression that the Development Bank has been given an initial sizeable working capital from the government and commercial banks (the shareholders) and some foreign organizations, and left to work on its own.

Beside the functions that the Central Bank already has, its role and powers should be expanded through legislation. Monetary policy is just one aspect of overall economic policy. Thus, monetary policy must clearly be to help accelerate economic development. The monetary authorities should encourage the credit institutions to develop financial instruments that will allow them to mobilize more savings with medium-term to long-term characteristics, which will aid in the development objectives of the Netherlands Antilles. The Central Bank might

have to relax the requirements on certain deposits, as they cause banks to focus on short-term lending.

The Central Bank should have the power to require the commercial banks and institutional investors and credit unions to allocate a certain proportion of their resources into projects that are consistent with the development objectives of the country.

If the government defines its high priority areas in accordance with those of the Development Bank, then there will be consistency of national interest. The plans to be carried out by the Ontwikkelings Bank will be in accordance with those of the government, and national interest will be best served.

The Central Bank can then require the financial institutions to direct their funds toward the approved projects of the Ontwikkelings Bank van de Nederlandse Antilles. In the case that the commercial banks would need funds, the bank could be a lender of last resort. The advantage is:

- 1) A continuous flow of funds to the Development Bank on which the Central Bank has control,
- 2) Less dependence on foreign resources,
- 3) Consistency, coordination, and cooperation between the financial sectors, government sector, Central Bank and Development Bank in the best interest of the country,
- 4) Resources are directed into the most socially and economically profitable uses,
- 5) Selective controls of the Central Bank become more effective, as productive investments are now clearly defined and so is the channel.

Another suggestion is as follows. In the long-run, the whole society will benefit from the activities of the high priority areas. So, the whole society should pay for the derived benefits. Hence, the government could impose an explicit tax on the community and the proceeds used for the high priority areas. This tax should be in accordance with the estimated external benefits conferred from this area. Such a measure would involve the whole community and create national awareness to work hard, to build up the country and that this is a responsibility of all of us, not just the government or the Central Bank or financial institutions.

In the state in which the economy finds itself right now, planning, cooperation, coordination, consistency, and hard work are required from each and every sector of the economy. If not, we shall all suffer.

Footnotes

1. Liquidity requirements are set, and monitored for both domestic and foreign business of commercial banks. No distinction is made between currencies.
2. Residents are understood to be:
 - a) natural persons residing or having their place of business in the Netherlands Antilles,
 - b) the legal entities established or having their place of business within the Netherlands Antilles.Nonresidents are understood to be: natural persons and legal entities not coming under the definition of residents.

6. REFERENCES

- Alvares, E. A., Jr. "Role of the Development Bank in the Netherlands Antilles." Unpublished (Lecture) Ontwikkelings Bank van de Nederlandse Antillen, Curacao, 1985.
- Antillen Review. "After a Sixty Year Presence Exxon Announces Closure of Lago Refinery." Antillen Review 4, No. 5 (1984): 11-12.
- Antillen Review. "Synopsis of a Bleak Situation." Antillen Review 4, No. 6 (1985a): 5-9.
- Antillen Review. "The Triumph of Common Sense." Antillen Review 5, No. 1 (1985b): 19-21.
- Antillen Review. "Bad News from Washington." Antillen Review 4, No. 3 (1985c): 24-27.
- Arowolo, Edward A. "The Development of Capital Markets in Africa with Particular Reference to Kenya and Nigeria." IMF Staff Papers 28, No. 2 (1971): 221-253.
- Beers, H. C. "The Financial Sectors of the Netherlands Antilles." Curacao: Drukkerij Scherpenheuvel N.V., 1980.
- Beers, H. C. "Kapitaal Markt in de Nederlandse Antillen." ATIA News 7, No. 1 (1981): 3-7. Openbare Bibliotheek, Curacao.
- Beers, H. C. "Savings Behaviour, Long Term Capital Shortage and the Role of the Commercial Banks in the Netherlands Antilles." Unpublished Paper. University of the Netherlands Antilles, Curacao, 1983.
- Beers, H. C. "Algemene Beschouwingen 1982: Een Uitstekende Analyse Maar Weinig Visie." Econotities No. 5 (1982): 22-23. Curacao: Department van Economische Zaken van de Nederlandse Antillen.
- Beniamini, Haim. "The Cooperatives in Curacao: Cooperation in the Netherlands Antilles." The Project for Organization and Development of Cooperatives in Curacao and the Netherlands Antilles, 1980.
- Bhatt, V. V. "Some Aspects of Financial Policies and Central Banking in Developing Countries." In Money and Monetary Policy in Less Developing Countries: A Survey of Issues and Evidence, pp. 115-128. Edited by Warren L. Coats, Jr. and Deena R. Khatkhate. New York: Pergamon Press Inc., 1983.

- Braam, H. L. "Hoe ons Land Geregeerd Wordt." Aruba: De Wit Stores N.V., 1972.
- Brigham, Eugene F. "Fundamentals of Financial Management." 3rd ed. New York: The Dryden Press, 1983.
- Central Bank Annual Reports. Bank van de Nederlandse Antillen, Curacao, various years, 1969-1980.
- Central Bank Quarterly Bulletin. Bank van de Nederlandse Antillen, Curacao, various years, 1977-1985.
- Coats, Warren L., Jr. "The Use of Reserve Requirements in Developing Countries. In Money and Monetary Policy in Less Developing Countries: A Survey of Issues and Evidence, pp. 401-423. Edited by Warren L. Coats, Jr. and Deena R. Khatkhate. New York: Pergamon Press Inc., 1983.
- Curacao International Trust Company N.V. "An Introduction to Taxation of Offshore Companies in the Netherlands Antilles." Curacao International Trust Company N.V., Curacao, 1982.
- Dorrance, Graeme S. "The Instruments of Monetary Policy in Countries Without Highly Developed Capital Markets." IMF Staff Papers 12, No. 2 (1965): 272-282.
- Dorrance, Graeme S. "The Role of Central Banks in Less Developed Countries." Finance and Development 6 (1969): 22-26.
- Evers, H. "Bankwezen Nederlandse Antillen: Belangrijke Structuur Veranderingen (deel I en II)." Unpublished report Werkgroep Integrale Ontwikkelings Planning. Openbare Bibliotheek, Curacao, 1974.
- Galbis, Vicente. "Small Open Economy." Finance and Development 21, No. 12 (1984): 36-37.
- Goslinga, Cornelis C. "A Short History of the Netherlands Antilles and Surinam." The Hague: Martinus Nijhoff Publishers BV, 1979.
- Haan, E. "Kapital Markt." Unpublished Memorandum. Bank van de Nederlandse Antillen, Curacao, 1984.
- Hopkins, Michael. "Zwitserland of the Caribbean or Haiti." Antillen Review 4, No. 2 (1984): 17-20.

- Johnson, O. E. G. "Credit Controls as Instruments of Development Policy in the Light of Economic Theory." In Money and Monetary Policy in Less Developing Countries: A Survey of Issues and Evidence, pp. 549-569. Edited by Warren L. Coats, Jr. and Deena R. Khatkhate. New York: Pergamon Press, Inc., 1983.
- Khatkhate, D. R. "The Nature and Scope of the Capital Market Development in the Netherlands Antilles." Unpublished Government Material. University of the Netherlands Antilles, Curacao, 1975.
- Khatkhate, D. R. "Monetary Policy Formulation and Objectives: Analytic Basis of the Working of Monetary Policy in Less Developed Countries." IMF Staff Papers 19, No. 3 (1972): 533-58.
- Koetsenruijter, A. "De Betekenis van de Tekortfinanciering van de Landsverordening voor de Antilliaanse Economie." Econotities No. 7 (1983): 2-11.
- Legarda, Benito. "Small Island Economies." Finance and Development 21, No. 12 (1984): 42-43.
- Luckett, Dudley G. "Money and Banking." New York: McGraw-Hill, 1976.
- Mathieson, John A. and Laudicina, Paul A. "The Netherlands Antilles: The Impact of Offshore Financial Activities." Final Report. Stanford Research Institute International, Arlington, Virginia, 1982.
- Meier, Gerald M. "Leading Issues in Economic Development." New York: Oxford University Press, 1976.
- Oduber, L. M. "De Financiële Structuur van de Nederlandse Antillen en Landsverordening Toezicht Bank en Kredietwezen." Unpublished Thesis. Katholieke Hogeschool Nederland, Tilburg, The Netherlands, 1983.
- Ontwikkelings Bank (Development Bank) van de Nederlandse Antillen. Annual Reports Curacao, various years, 1980-1982.
- Patrick, H. T. "Financial Development and Economic Growth in Underdeveloped Countries." In Money and Monetary Policy in Less Developing Countries: A Survey of Issues and Evidence, pp. 37-54. Edited by Warren L. Coats, Jr. and Deena R. Khatkhate. New York: Pergamon Press, Inc., 1983.
- Pearce, Douglas K. "Recent Developments in the Credit Union Industry." Economic Review (Federal Reserve Bank of Kansas) (1984): 3-19.

- Roussakis, Emmanuel. "Offshore Banking." Unpublished material. University of the Netherlands Antilles, Curacao, 1985.
- Saab, S. N. "De Venezuela Problematiek en de Effecten op de Antilliaanse Economie." *Econotities* 7 (1983): 11-15. Curacao: Department van Economische Zaken van de Nederlandse Antillen.
- Smeets, A. A. G. "Ontwikkeling van de Offshore Activiteiten op de Nederlandse Antillen." In Opstellen ter Gelegenheid van het 110-jarige Bestaan van de Kamer van Koop-handel en Nijverheid te Curacao, pp. 229-245. Edited by O. B. Linker. Curacao: Chamber of Commerce, 1985.
- Smits, P. A. M. and Willemse, A. H. "Het Bankwezen in de Nederlandse Antillen." University of the Netherlands Antilles, Curacao, 1974.
- Snoek, H. A. "Monetaire Ontwikkelingen in de Nederlandse Antillen." *Econotities* No. 2 (1981): 2-7. Curacao: Department van Economische Zaken van de Nederlandse Antillen.
- Snoek, H. A. "De Landsbegroting: Enkele Economische en Monetaire Aspecten." *Econotities* No. 5 (1982a): 5-18. Curacao: Department van Economische Zaken van de Nederlandse Antillen.
- Snoek, H. A. "De Economie van de Nederlandse Antillen." *Econotities* No. 1 (1982b): 14-16. Curacao: Department van Economische Zaken in de Nederlandse Antillen.
- Snoek, H. A. "Disconto Beleid van de Nederlandse Antillen Vrij Ineffectief." *Brasia* 5, No. 4, University of the Netherlands Antilles, Curacao, 1984.
- Stanford, Jon D. "Money Banking and Economic Activity." New York: John Wiley and Sons, Australasia Ltd., 1972.
- Van Soest, Jaap. *Trustee of the Netherlands Antilles: A History of Money, Banking and the Economy with Special Reference to the Central Bank of the Netherlands Antilles 1828-6 February 1978*. University of the Netherlands Antilles, Curacao, 1978.

7. ACKNOWLEDGMENTS

I would like to use this opportunity to express my sincere gratitude to all those who directly or indirectly assisted me in making this thesis a reality.

My special appreciation goes to my advisor, Dr. Dudley G. Lockett, who accepted to guide and direct my research, for all his help, suggestions and comments.

To my committee members, Dr. Ross Talbot, professor of Political Science, and Dr. Charles Meyer of the Economics Department, I say thanks for your friendly cooperation.

Special thanks to the Director of the Bank van de Nederlandse Antillen, Dr. L. Wong, who allowed me to do my research at the Central Bank.

I also would like to thank the following staff members of the Research Department of the Bank van de Nederlandse Antillen, namely: Mrs. Lisanne Maduro Oduber, Mr. Richard Isa, and Mr. Kenneth Pietersz, especially for their patience. Without their untiring assistance and availability this work would not have been completed.

My thanks also go to Mrs. LaDena Bishop of the Thesis Office of Iowa State University for her valuable advice and corrections as well as Mrs. Maggie Wheelock who typed my thesis, for her competence and speed.

Last but not least, my thanks go to my wife Nereida, my parents, Max and Anna, my brother, Humphrey, and sisters, Elcira and Yvonne, for their unfailing encouragement and moral support.

8. APPENDIX 1

Table 8.1 Primary institutions^a

	ABA	CUR	BON	SXM	SA	STE
Algeme Bank Nederland N.V.	X	X	X	X		
Aruba Bank N.V.	X					
Banco di Caribe N.V.		X				
Banco Industrial de Venezuela C.A.		X				
Barclays Bank PLC	X	X	X	X	X	X
The First National Bank of Boston		X				
Caribbean Mercantile Bank N.V. ^b	X					
Citibank N.A.	X					
Maduro & Curiel's Bank N.V.		X				
Maduro & Curiel's Bank (Bonaire) N.V. ^b			X			
The Bank of Nova Scotia N.V.				X		
The Chase Manhattan Bank N.A.				X		
The Windward Islands Bank Ltd. ^b				X		
The Girodienst Curacao		X				
Pierson Helderling and Pierson (N.A.) N.V.		X				
Curacao Banking Corporation N.V.						

^a ABA = Aruba
 CUR = Curacao
 BON = Bonaire
 SXM = St. Maarten
 SA = SABA
 STE = St. Eustatius

^b These are subsidiaries of Maduro and Curiel's Bank N.V.

9. APPENDIX 2

Holding companies own 100% of the shares of foreign corporations (primarily in the United States) and receive dividends from those firms at reduced withholding tax rates;

Investment companies include portfolio companies, mutual funds and privately owned family funds which manage a variety of financial investments;

Real estate companies are established to channel funds into real estate markets (primarily in the United States);

Royalty companies own the rights to and receive the income from patents and copyrights in both the industrial and artistic fields;

Offshore trading companies carry out transactions on international sales and purchases of merchandise goods, and, in some cases, perform transshipment services;

Shipping companies are utilized to register vessels in the Netherlands Antilles;

Factoring companies finance the operations of companies or retail and wholesale sales through the purchase of accounts receivable.